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REVENUE ACT OF 1935

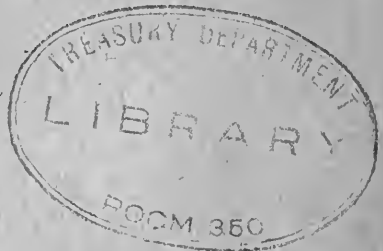
HEARINGS
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
SEVENTY-FOURTH CONGRESS
FIRST SESSION
ON

H. R. 8974

AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION
AND FOR OTHER PURPOSES

JULY 30, 31, AUGUST 1, 2, 6, 7, AND 8, 1935

Printed for the use of the Committee on Finance



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GOVERNMENT PRINTING OFFICE
WASHINGTON : 1935



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REVENUE ACT OF 1935

TUESDAY, JULY 30, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to call, at 10 a. m., in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

Present: Senators Harrison (chairman), King, Walsh, Connally, Gore, Costigan, Byrd, Gerry, Guffey, La Follette, and Capper.

The CHAIRMAN. The Senators have before them a copy of the bill that was introduced yesterday by Congressman Doughton and it was reported out, I understand, this morning. We have had some requests for hearings. I haven't felt like we ought to bring people here until they saw a copy of this bill, so we will have the witnesses in the morning.

STATEMENT OF L. H. PARKER, CHIEF OF STAFF, JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

The CHAIRMAN. Mr. Parker, will you just briefly give us an explanation of this bill now? I wish that you would at the same time differentiate between what has been done in the introduction of the bill and the President's suggestions in his message. In other words, what more have they done than the President suggested be done in his message?

(The message of the President is as follows:)

[H. Doc. No. 229, 74th Cong., 1st sess.]

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING VIEWS ON THE BROAD QUESTION OF TAX METHODS AND POLICIES

To the Congress of the United States:

As the fiscal year draws to its close it becomes our duty to consider the broad question of tax methods and policies. I wish to acknowledge the timely efforts of the Congress to lay the basis through its committees for administrative improvements, by careful study of the revenue systems of our own and of other countries. These studies have made it very clear that we need to simplify and clarify our revenue laws.

The Joint Legislative Committee, established by the Revenue Act of 1926, has been particularly helpful to the Treasury Department. The members of that committee have generously consulted with administrative officials, not only on broad questions of policy but on important and difficult tax cases.

On the basis of these studies and of other studies conducted by officials of the Treasury, I am able to make a number of suggestions of important changes in our policy of taxation. These are based on the broad principle that if a government is to be prudent its taxes must produce ample revenues without discouraging enterprise; and if it is to be just it must distribute the burden of taxes equitably. I do not believe that our present system of taxation completely meets this test.

Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power.

With the enactment of the income-tax law of 1913 the Federal Government began to apply effectively the widely accepted principle that taxes should be levied in proportion to ability to pay and in proportion to the benefits received. Income was wisely chosen as the measure of benefits and of ability to pay. This was and still is a wholesome guide for national policy. It should be retained as the governing principle of Federal taxation. The use of other forms of taxes is often justifiable, particularly for temporary periods; but taxation according to income is the most effective instrument yet devised to obtain just contribution from those best able to bear it and to avoid placing onerous burdens upon the mass of our people.

The movement toward progressive taxation of wealth and of income has accompanied the growing diversification and interrelation of effort which marks our industrial society. Wealth in the modern world does not come merely from individual effort; it results from a combination of individual effort and of the manifold uses to which the community puts that effort. The individual does not create the product of his industry with his own hands; he utilizes the many processes and forces of mass production to meet the demands of a national and international market.

Therefore, in spite of the great importance in our national life of the efforts and ingenuity of unusual individuals, the people in the mass have inevitably helped to make large fortunes possible. Without mass cooperation great accumulations of wealth would be impossible save by unhealthy speculation. As Andrew Carnegie put it, "Where wealth accrues honorably, the people are always silent partners." Whether it be wealth achieved through the cooperation of the entire community or riches gained by speculation—in either case the ownership of such wealth or riches represents a great public interest and a great ability to pay.

I

My first proposal, in line with this broad policy has to do with inheritances and gifts. The transmission from generation to generation of vast fortunes by will, inheritance, or gift is not consistent with the ideals and sentiments of the American people.

The desire to provide security for one's self and one's family is natural and wholesome, but it is adequately served by a reasonable inheritance. Great accumulations of wealth cannot be justified on the basis of personal and family security. In the last analysis such accumulations amount to the perpetuation of great and undesirable concentration of control in a relatively few individuals over the employment and welfare of many, many others.

Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our Government.

Creative enterprise is not stimulated by vast inheritances. They bless neither those who bequeath nor those who receive. As long ago as 1907, in a message to Congress, President Theodore Roosevelt urged this wise social policy:

"A heavy progressive tax upon a very large fortune is in no way such a tax upon thrift or industry as a like tax would be on a small fortune. No advantage comes either to the country as a whole or to the individuals inheriting the money by permitting the transmission in their entirety of the enormous fortunes which would be affected by such a tax; and as an incident to its function of revenue raising, such a tax would help to preserve a measurable equality of opportunity for the people of the generations growing to manhood."

A tax upon inherited economic power is a tax upon static wealth, not upon that dynamic wealth which makes for the healthy diffusion of economic good.

Those who argue for the benefits secured to society by great fortunes invested in great businesses should note that such a tax does not affect the essential benefits that remain after the death of the creator of such a business. The mechanism of production that he created remains. The benefits of corporate organization remain. The advantage of pooling many investments in one enterprise remains. Governmental privileges such as patents remain. All that is gone is the initiative, energy, and genius of the creator—and death has taken these away.

I recommend, therefore, that in addition to the present estate taxes, there should be levied an inheritance, succession, and legacy tax in respect to all very large amounts received by any one legatee or beneficiary; and to prevent, so far as possible, evasions of this tax, I recommend further the imposition of gift taxes suited to this end.

Because of the basis on which this proposed tax is to be levied and also because of the very sound public policy of encouraging a wider distribution of wealth, I strongly urge that the proceeds of this tax should be specifically segregated and applied, as they accrue, to the reduction of the national debt. By so doing we shall progressively lighten the tax burden of the average taxpayer, and, incidentally, assist in our approach to a balanced budget.

II

The disturbing effects upon our national life that come from great inheritances of wealth and power can in the future be reduced, not only through the method I have just described, but through a definite increase in the taxes now levied upon very great individual net incomes.

To illustrate: The application of the principle of a graduated tax now stops at \$1,000,000 of annual income. In other words, while the rate for a man with a \$6,000 income is double the rate for one with a \$4,000 income, a man having a \$5,000,000 annual income pays at the same rate as one whose income is \$1,000,000.

Social unrest and a deepening sense of unfairness are dangers to our national life which we must minimize by rigorous methods. People know that vast personal incomes come not only through the effort or ability or luck of those who receive them, but also because of the opportunities for advantage which government itself contributes. Therefore the duty rests upon the Government to restrict such incomes by very high taxes.

III

In the modern world, scientific invention and mass production have brought many things within the reach of the average man which in an earlier age were available to few. With large-scale enterprises has come the great corporation drawing its resources from widely diversified activities and from a numerous group of investors. The community has profited in those cases in which large-scale production has resulted in substantial economies and lower prices.

The advantages and the protections conferred upon corporations by government increase in value as the size of the corporation increases. Some of these advantages are granted by the State which conferred a charter upon the corporation. Others are granted by other States which, as a matter of grace, allow the corporation to do local business within their borders. But perhaps the most important advantages, such as the carrying on of business between two or more States are derived through the Federal Government—great corporations are protected in a considerable measure from the taxing power and the regulatory power of the States by virtue of the interstate character of their business. As the profit to such a corporation increases, so the value of its advantages and protections increases.

Furthermore, the drain of a depression upon the reserves of business puts a disproportionate strain upon the modestly capitalized small enterprise. Without such small enterprises our competitive economic society would cease. Size begets monopoly. Moreover, in the aggregate these little businesses furnish the indispensable local basis for those Nation-wide markets which alone can insure the success of our mass-production industries. Today our smaller corporations are fighting not only for their own local well-being but for that fairly distributed national prosperity which makes large-scale enterprise possible.

It seems only equitable, therefore, to adjust our tax system in accordance with economic capacity, advantage, and fact. The smaller corporations should not carry burdens beyond their powers; the vast concentrations of capital should be ready to carry burdens commensurate with their powers and their advantages.

We have established the principle of graduated taxation in respect to personal incomes, gifts, and estates. We should apply the same principle to corporations. Today the smallest corporation pays the same rate on its net profits as the corporation which is a thousand times its size.

I, therefore, recommend the substitution of a corporation income tax graduated according to the size of corporation income in place of the present uniform corporation income tax of 13½ percent. The rate for smaller corporations might well be reduced to 10½ percent, and the rates graduated upward to a rate of 16½ percent on net income in the case of the largest corporations, with such classifications of business enterprises as the public interest may suggest to the Congress.

Provision should, of course, be made to prevent evasion of such graduated tax on corporate incomes through the device of numerous subsidiaries or affiliates, each of which might technically qualify as a small concern even though all were in fact operated as a single organization. The most effective method of preventing such evasions would be a tax on dividends received by corporations. Bona fide

investment trusts that submit to public regulation and perform the function of permitting small investors to obtain the benefit of diversification of risk may well be exempted from this tax.

In addition to these three specific recommendations of changes in our national tax policies, I commend to your study and consideration a number of others. Ultimately we should seek through taxation the simplification of our corporate structures through the elimination of unnecessary holding companies in all lines of business. We should likewise discourage unwieldy and unnecessary corporate surpluses. These complicated and difficult questions cannot adequately be debated in the time remaining in the present session of this Congress.

I renew, however, at this time the recommendations made by my predecessors for the submission and ratification of a constitutional amendment whereby the Federal Government will be permitted to tax the income on subsequently issued State and local securities and likewise for the taxation by State and local governments of future issues of Federal securities.

In my Budget message of January 7, I recommended that the Congress extend the miscellaneous internal revenue taxes which are about to expire and also to maintain the current rates of those taxes which, under the present law, would be reduced. I said then that I considered such taxes necessary to the financing of the Budget for 1936. I am gratified that the Congress is taking action on this recommendation.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE, June 19, 1935.

MR. PARKER. Mr. Chairman and members of the committee, the bill, H. R. 8974, which was introduced in the House yesterday by Mr. Doughton, Chairman of the Committee on Ways and Means, is divided into four titles. The first title contains certain amendments to the Revenue Act of 1934, dealing with income tax and excess-profits taxes. The second title of the bill provides for an inheritance tax.

Senator GORE. Which does that?

MR. PARKER. The second title of the bill provides for an inheritance tax, which is an entirely new tax and is imposed in addition to our two existing estate taxes.

Title III of the bill provides for a gift tax on donees, which is in addition to our present gift tax on donors. That tax is complementary to the inheritance tax and is designed to prevent the evasion of that tax.

Title IV simply contains a few general provisions.

The CHAIRMAN. What about the corporation tax?

MR. PARKER. The corporation tax is included in title I, Senator.

Senator GORE. Under the income tax?

MR. PARKER. Under the amendments to the Revenue Act of 1934.

The CHAIRMAN. In other words, title I has not only got the increase of surtaxes but has got the corporation increase.

MR. PARKER. Yes, sir; and also the excess-profits tax.

Now, the President, in his message of June 19, made three major recommendations. He recommended increasing surtaxes, he recommended a graduated income tax on corporations, and he recommended an inheritance and gift tax.

The CHAIRMAN. He recommended a surtax increase on over a million dollars, is that right?

MR. PARKER. He did that by way of example, pointing out that our present graduated surtax ceased further graduation at the million-dollar point. He stated that by way of example, and he recommended that the defect be corrected.

The CHAIRMAN. Yes. Now, what this bill has done, you start at \$50,000 instead of a million dollars to increase the tax.

Mr. PARKER. The surtax adjustment begins at \$50,000, that is correct.

The CHAIRMAN. There is an increase over \$50,000 under the present law?

Mr. PARKER. That is correct.

The CHAIRMAN. You carry it on up to over a million dollars?

Mr. PARKER. Yes.

The CHAIRMAN. And you reach a maximum?

Mr. PARKER. At \$5,000,000.

The CHAIRMAN. And that rate is what?

Mr. PARKER. The maximum rate is 75 percent on the amount of surtax net income over \$5,000,000.

The CHAIRMAN. Plus the 4 percent?

Mr. PARKER. Plus the 4 percent.

The CHAIRMAN. Which would be 79 percent?

Mr. PARKER. The maximum rate on a dollar of net income is 79 percent.

Senator GORE. At that point, Mr. Parker, do you happen to know what the State income tax or the city income tax of New York happens to be?

Mr. PARKER. New York State has an income tax that is not very high. I will have to give you the exact figure later.

Senator GORE. The two combined, as I remember, are 22 percent. I am not certain about that.

Mr. PARKER. The highest rate of the tax, I believe, in the States on income is 15 percent, but I do not think that is the rate in New York State. I think the New York rate is 3 percent.

Senator GORE. I had seen a statement in the newspapers that the two combined were 32 percent, which would make the tax 101 percent.

Mr. PARKER. You cannot figure the State taxes in that way, because we give a deduction for the State income tax paid and most States give deductions for Federal income tax paid. So as long as a reduction is given you never reach 100 percent, but it does, of course, impose an added burden. The city of New York imposes an income tax. It was based on the income shown in the Federal income-tax return. I understand, informally, that this tax has either been repealed or is not being enforced.

Senator GORE. It was a certain percentage at least of the Federal return?

Mr. PARKER. Yes, Senator; and I might add that California has quite a high tax.

The CHAIRMAN. Have you a table there of the income tax, showing the increase above \$50,000?

Mr. PARKER. Yes, Senator, I have such a table.

The CHAIRMAN. I wish you would put it into the record.

Mr. PARKER. I will put the table in the record, and I might explain it briefly.

(The table referred to is as follows:)

Revised surtax schedule beginning at \$50,000

Surtax net income bracket	Proposed rate	Present rate	Proposed total surtax ¹	Present total surtax ¹
	<i>Percent</i>	<i>Percent</i>		
\$50,000 to \$56,000.....	31	30	\$9,560	\$9,500
\$56,000 to \$62,000.....	35	33	11,660	11,480
\$62,000 to \$68,000.....	39	36	14,000	13,640
\$68,000 to \$74,000.....	43	39	16,500	15,980
\$74,000 to \$80,000.....	47	42	19,400	18,500
\$80,000 to \$90,000.....	51	45	24,500	23,000
\$90,000 to \$100,000.....	55	50	30,000	28,000
\$100,000 to \$150,000.....	58	52	59,000	54,000
\$150,000 to \$200,000.....	60	53	89,000	80,000
\$200,000 to \$250,000.....	62	54	120,000	107,500
\$250,000 to \$300,000.....	64	54	152,000	134,500
\$300,000 to \$400,000.....	66	55	218,000	189,500
\$400,000 to \$500,000.....	68	56	286,000	245,500
\$500,000 to \$750,000.....	70	57	461,000	388,000
\$750,000 to \$1,000,000.....	72	58	641,000	533,000
\$1,000,000 to \$2,000,000.....	73	59	1,371,000	1,123,000
\$2,000,000 to \$3,000,000.....	74	59	3,591,000	2,893,000
Over \$5,000,000.....	75	59	-----	-----

¹ Computed on upper limit of bracket; for example, proposed surtax on \$62,000 is \$11,660, and present surtax on this amount is \$11,480.

Mr. PARKER. The first amendment in title I of the bill in section 101, relates to surtaxes on individuals, and as has already been stated, the surtax changes begin at \$50,000. The present bracket is \$50,000 to \$56,000. The bracket is not changed. The present surtax rate at that point is 30 percent. The rate contained in the bill is 31 percent, an increase of 1 percent.

The CHAIRMAN. Let me get that. That is not the first item. The first is surtax in excess of \$44,000, not in excess of \$50,000. You do not change that?

Mr. PARKER. We do not change that; that is present law. All after that bracket is stricken out, all brackets beginning with line 4 on page 2 are substituted.

The CHAIRMAN. You increase that 1 percent?

Mr. PARKER. We increase that 1 percent, and the surtax on \$56,000, line 7, now becomes \$9,560. It was \$9,500. So, there is an increase of tax on a surtax net income of \$56,000 of \$60.

The CHAIRMAN. What percentage is that?

Mr. PARKER. Well, that would be, of course, a very small percentage. It would be about a little over one-tenth of 1 percent.

The CHAIRMAN. So the proportion there of the increase is not the same as in the bracket above?

Mr. PARKER. No; the increases get larger and larger as you proceed up the surtax scale.

The CHAIRMAN. You did not get larger there than the prior provision, you got lower. What percent increase over the present law, from \$50,000 to \$56,000, and the present law is 30 percent and this bill is 31 percent, which is a 1 percent increase.

Mr. PARKER. That is right.

The CHAIRMAN. But from the \$56,000 to \$62,000 the increase is only \$60?

Mr. PARKER. No, Senator. I mean that the surtax on a surtax net income of \$56,000, that is before you reach the 35 percent, was

increased \$60. That increase is wholly due to the 1 percent applied to the \$6,000 bracket between \$50,000 and \$60,000. One percent of \$6,000 is \$60.

Now in the next bracket, from \$56,000 to \$62,000, the present rate is 33 percent and the proposed rate is 35 percent.

The CHAIRMAN. A 2 percent increase?

Mr. PARKER. A 2 percent increase there. So that when we compute the surtax on an income of \$62,000 we have a surtax of \$11,660 instead of a surtax of \$11,480, as under the present law, which is an increase at that point of \$180.

Now skipping a few brackets, and coming down to the \$100,000 bracket—

The CHAIRMAN. Let us take up the \$62,000 to \$68,000, lines 11 and 12.

Mr. PARKER. \$62,000 to \$68,000, the proposed rate is 39 percent and the present rate is 36 percent.

The CHAIRMAN. A 3 percent increase.

Mr. PARKER. A 3 percent increase. The surtax on \$68,000 is \$14,000. The former surtax on that amount was \$13,640, giving an increase of \$360.

The CHAIRMAN. Take them right down.

Mr. PARKER. The next bracket is from \$68,000 to \$74,000. The proposed rate is 43 percent, as compared with a present rate of 39 percent. The surtax on \$74,000 will be \$16,580, as compared with a present surtax of \$15,980, representing a \$600 increase.

Senator KING. What is the percentage of increase?

The CHAIRMAN. Four percent.

Senator KING. It would be 51 percent?

Mr. PARKER. No; not at that point. We are in lines 13 to 15, Senator. The proposed rate is 43 percent, and the old rate is 39 percent.

Senator KING. Yes.

Mr. PARKER. In the next bracket, from \$74,000 to \$80,000, the proposed rate is 47 percent as compared with an existing rate of 42 percent of surtax.

Senator GORE. How much is the proposed tax?

Mr. PARKER. The proposed tax on \$80,000 is 47 percent on surtax net incomes between \$74,000 and \$80,000.

The CHAIRMAN. And it was what?

Mr. PARKER. It was 42 percent.

The CHAIRMAN. A 5 percent increase.

Senator GORE. Tell me this: Is there a scheme that runs through this, is it graduated so we could tell from what you said what it would be in each succeeding bracket, or is it more or less arbitrary?

Mr. PARKER. No; it follows, of course, a rather smooth curve and advances gradually, but there is a continual increase the higher up the scale it goes.

Senator GORE. Not at a given percentage or at a given arbitrary figure?

Mr. PARKER. You see, we start off in the first bracket with \$50,000 to \$56,000, with only a 1 percent increase, but when we get up above \$5,000,000 then we have got a differential between 59 percent and 75 percent, or a 16 percent increase. Now we have gone up gradually and increased the rate in each bracket, so we proceed from the 1 percent differential to the 16 percent differential.

Senator GORE. That stepping-up process, is it on a percentage basis, or is it a regular advance, or is it more or less arbitrary?

Mr. PARKER. It is based on a regular advance, but it is as is always the case with surtaxes, arbitrary. Nobody can sit down and write any particular formula on just what his ability to pay is.

Senator GORE. It goes up, after it gets started, in each bracket, so much advance either in point of percentage or in point of cents?

Mr. PARKER. It goes in simple mathematical progression. The first bracket advances 1 percent, the second bracket 2 percent and so on.

Senator GORE. And the third what? Three?

Mr. PARKER. Yes.

Senator GORE. And the next 4?

Mr. PARKER. That is correct, but that has to be smoothed out, and it does not follow that exactly all the way through.

Senator GORE. If it did I would want to know it.

The CHAIRMAN. Mr. Parker, will you now insert in the record that table that shows the percentage of increase from the \$50,000 over the present law and shows the amount of the increase?

Mr. PARKER. That has already been done.

The CHAIRMAN. By virtue of that change.

Mr. PARKER. That is correct; yes.

The CHAIRMAN. Put that in the record. Will you skip to where it stops now? It stopped at what amount?

Mr. PARKER. It stopped at \$5,000,000.

The CHAIRMAN. We are talking about the present law.

Mr. PARKER. The present law ceases graduation at \$1,000,000.

The CHAIRMAN. Let us get down to the \$1,000,000.

Senator KING. That is line 5, page 4.

The CHAIRMAN. On the \$1,000,000 you have a rate of 73 percent, between \$1,000,000 and \$2,000,000.

Mr. PARKER. That is correct.

The CHAIRMAN. What is the present law?

Mr. PARKER. The present law is 59 percent over \$1,000,000, and the present surtax on \$1,000,000 is \$533,000.

The CHAIRMAN. Let us get the difference in percentage first: 59 percent, and it is now 73 percent?

Mr. PARKER. Yes. That is 14 percent.

Senator GORE. State that again, Mr. Parker.

Mr. PARKER. The rate over \$1,000,000 is proposed in this bill to be 73 percent. At present the rate over \$1,000,000 is 59 percent.

Senator GORE. That is the highest, as I understand it?

Mr. PARKER. That is correct.

The CHAIRMAN. What is the amount of difference in dollars?

Mr. PARKER. It is the difference between \$533,000 and \$641,000, or \$108,000.

The CHAIRMAN. \$108,000 increase.

Senator GORE. What is the top of your brackets there? You jump from \$1,000,000 to what?

Mr. PARKER. The proposed schedule graduates the rate somewhat from \$1,000,000 to \$5,000,000.

Senator GORE. Yes. What is the next one?

Mr. PARKER. The present law does not graduate at all above \$1,000,000.

Senator GORE. What is the next step from \$1,000,000?

Mr. PARKER. \$1,000,000 to \$2,000,000 is 73 percent.

Senator GERRY. You jump 14 percent from the \$1,000,000 to \$2,000,000?

Mr. PARKER. That is correct, Senator.

The CHAIRMAN. Now let us get the bracket before that. Below \$1,000,000 you get it from \$750,000 to \$1,000,000, and the proposed rate is 72 percent. What is the present law on that?

Mr. PARKER. The present law is 58 percent.

The CHAIRMAN. Then you have got the same percentage?

Mr. PARKER. You still get 14 percent there.

The CHAIRMAN. And the amount in dollars is what?

Mr. PARKER. The amount in dollars on a \$750,000 net income is \$388,000.

The CHAIRMAN. Increase?

Mr. PARKER. No, \$388,000 under the present law and the proposed surtax is \$461,000, which is \$173,000 increase.

The CHAIRMAN. \$173,000 increase?

Mr. PARKER. No; I mean \$73,000 increase. I beg your pardon.

The CHAIRMAN. \$73,000 increase. May I ask you, the President in his message, for my interpretation and I think for the country's interpretation, was that he wanted these rates increased above \$1,000,000.

Mr. PARKER. If you do not mind, Senator, I will read just what the President said on that point.

The CHAIRMAN. All right.

Mr. PARKER. That is the pertinent part of it.

Senator KING. May I ask, are you trying to follow the President's recommendations?

The CHAIRMAN. That is what I want to do, I want to follow the President's recommendation.

Senator KING. I only asked him whether he is trying to follow it.

Mr. PARKER. Of course, Senator, as far as I was concerned I followed the instructions of the Ways and Means Committee.

The CHAIRMAN. Let us see just what the President said.

Senator GORE. The President proposed a higher tax after it reached a million dollars.

Mr. PARKER. Let me read just what the President said.

Senator GORE. All right.

Mr. PARKER (reading):

The application of the principle of a graduated tax now stops at \$1,000,000 of annual income.

The CHAIRMAN. Where is that, on what page?

Senator KING. That is on page 3.

Mr. PARKER. That is on page 3 of the President's message.

The CHAIRMAN. All right.

Mr. PARKER. In fact I will read all he says about this, because it is very short. [Reading:]

The disturbing effects upon our national life that come from great inheritances of wealth and power can in the future be reduced, not only through the method I have just described, but through a definite increase in the taxes now levied upon very great individual net incomes.

To illustrate: The application of the principle of a graduated tax now stops at \$1,000,000 of annual income. In other words, while the rate for a man with

a \$6,000 income is double the rate for one with a \$4,000 income, a man having a \$5,000,000 annual income pays at the same rate as one whose income is \$1,000,000.

Social unrest and a deepening sense of unfairness are dangers to our national life which we must minimize by rigorous methods. People know that their personal incomes come not only through the effort or ability or luck of those who receive them, but also because of the opportunities for advantage which Government itself contributes. Therefore the duty rests upon the Government to restrict such incomes by very high taxes.

That is all that the President said on that particular point.

The CHAIRMAN. So it was construed, from that language, that they ought to start at \$50,000 and increase them from there instead of from \$1,000,000, and then increase them?

Mr. PARKER. That was the decision of the committee, Senator. Of course there is no substantial revenue to be obtained by graduating the surtaxes from the \$1,000,000 point. All you could secure from such a graduation is perhaps \$5,000,000 to \$6,000,000, whereas, under the proposal of the committee it is estimated that the revenue will be about \$45,000,000.

The CHAIRMAN. I can understand that. If we go further down we will get that much more money, but did the Treasurer recommend this increase from \$50,000 to \$1,000,000, or did the Joint Committee on Internal Revenue taxation, through you, recommend it, or was it on the initiative of the committee itself?

Mr. PARKER. The Treasury made no recommendation. We made no recommendation in the joint committee. Of course we prepared the schedule and the Committee on Ways and Means decided where they wanted to stop and start.

The CHAIRMAN. Did the Treasurer express his views to the Ways and Means Committee on this proposition?

Mr. PARKER. No, Senator, he did not.

Senator GORE. He left the Ways and Means Committee a free hand, did he not? Mr. Morgenthau refused to make any recommendations specifically?

Mr. PARKER. That is substantially correct, I think.

Senator GORE. May I ask you whether you reported into the hearing the information which you obtained in your study of revenue in Great Britain on the income tax and inheritance tax?

Mr. PARKER. I gave a considerable amount of figures by way of comparison with the British rates, but the British system was not fully discussed. Of course, the committee was under a great pressure in preparing this bill, and they did not consider at all fully any possibility of going into the British system.

Senator GORE. Without of course inquiring into the *modus operandi* in the House Ways and Means Committee hearing, was there a goal set up to reach a certain amount of revenue to be obtained, and then the application of that principle running through the entire levy, from the smallest brackets up to the highest?

Mr. PARKER. No, Senator, there was no definite goal set, but of course the members did indicate that they wanted to get a substantial revenue from the bill.

Senator GORE. How much?

Mr. PARKER. They wanted to get as much as possible without going into a complete revision of our revenue system.

The CHAIRMAN. Well, haven't you always contended, Mr. Parker, and other gentlemen who have given study to this proposition, that

you could not get a great amount of taxes when you reached way up yonder into the \$5,000,000, or \$1,000,000, or \$2,000,000 class?

Mr. PARKER. That is correct.

The CHAIRMAN. That there were a very limited number of those people and you could only reach a limited amount, is not that right?

Mr. PARKER. That is correct. The number is very limited. It is very surprising even how limited the number is above \$50,000. Really, a substantial revenue can only be secured by increasing the surtaxes all along the line from \$4,000 up. You might be interested at that point to have a few figures as to how many individuals there are in the country with net incomes in excess of \$50,000.

The CHAIRMAN. Give it to us in excess of \$1,000,000 first, and then give it to us in the other amounts.

Mr. PARKER. Well, the number of those with incomes in excess of \$1,000,000 in 1924 was 75.

Senator GERRY. When was that, 1924?

Mr. PARKER. In 1924 there were 75 individuals. In 1929 there were 513.

Senator COSTIGAN. Is that the maximum number?

Mr. PARKER. That is the maximum number. In 1930 there were 150. In 1932 there were only 20. In 1933 there were 46. Now, 1933 is the last information we have, and I might say at that point that there were only 35 with net incomes between \$1,000,000 and \$2,000,000, 10 persons with net incomes between \$2,000,000 and \$5,000,000.

Senator GORE. When was that?

Mr. PARKER. In 1933, and only one person in the United States in 1933 with a net income of over \$5,000,000. Now, even if we go way down to \$50,000, in 1933 there were only 7,974 individuals reporting the net income of over \$50,000.

Senator GORE. What year?

Mr. PARKER. 1933. That is the last year available. Approximately 8,000 individuals with net incomes of over \$50,000. That is out of a total number of returns filed of 4,000,000, of which over one-half are nontaxable, leaving only 2,000,000 taxable returns.

Senator LA FOLLETTE. Mr. Parker, will you incorporate a table in the record showing the number of returns in each one of the brackets? (The table referred to is as follows:)

Number of individual returns (net incomes of over \$50,000)

Net income class	Calendar year				
	1924	1929	1930	1932	1933
\$50,000 to \$100,000.....	15,816	24,073	13,645	5,902	5,927
\$100,000 to \$150,000.....	3,065	6,376	3,111	995	1,085
\$150,000 to \$300,000.....	1,876	5,310	2,071	595	693
\$300,000 to \$500,000.....	457	1,641	552	140	139
\$500,000 to \$1,000,000.....	242	976	318	86	84
\$1,000,000 to \$2,000,000.....	50	357	110	15	35
\$2,000,000 to \$5,000,000.....	22	118	32	5	10
Over \$5,000,000.....	3	38	8	0	1
Total number of returns (with over \$50,000 of net income each).....	21,531	38,889	19,847	7,738	7,974

Mr. PARKER. I will be glad to do so, sir.

Senator GERRY. What was that number in 1924?

Mr. PARKER. Over \$1,000,000 or over \$50,000, Senator?

Senator GERRY. Over \$50,000.

Mr. PARKER. Over \$50,000 it was 21,531.

Senator GERRY. And in 1929?

Mr. PARKER. Thirty-eight thousand eight hundred and eighty-nine.

The CHAIRMAN. Mr. Parker, how much do you expect to get in revenue now out of the House bill? What is the estimate?

Mr. PARKER. On all the provisions in the House bill?

The CHAIRMAN. Just on the increase in the income tax.

Mr. PARKER. \$45,000,000.

The CHAIRMAN. Is that your estimate, or is that the estimate of the Treasury?

Mr. PARKER. That is my estimate, but it is based on certain other estimates of the Treasury. It is consistent with them.

The CHAIRMAN. Has the Treasury given an estimate on this proposition at all?

Mr. PARKER. I have given my figures. I haven't received their official estimates.

The CHAIRMAN. We will have the Secretary of the Treasury down here to give us an explanation and an analysis of the proposition and an estimate of the Treasury Department.

Senator COSTIGAN. Is that an estimated increase under title I?

Mr. PARKER. No; that is just the first section, section 101 of title I. In title I there are a number of different propositions that are really separate, but they are all in that title.

Senator GERRY. Have you got a table showing the increase in percentage and the increase in amount in parallel columns in reference to this new income tax?

The CHAIRMAN. That is put in the record.

Senator GERRY. Has it been put in the record?

Mr. PARKER. Yes, Senator.

The CHAIRMAN. Now let us get to page 5, section (b), net income tax on corporations.

Mr. PARKER. Section 102 on page 4 is where the graduated income tax on corporations is set forth. Under existing law corporations pay a flat rate of tax of 13¾ percent. That is on their entire amount of net income. It does not make any difference whether it is a dollar or a million dollars, they pay 13¾ percent. I call your attention to the fact that there is no specific exemption allowed, as was the case in many former revenue acts. For instance, in the revenue act of 1928 a corporation with a net income of less than \$25,000 had a specific exemption of \$3,000. That is to say, if a corporation made only \$3,000 it paid no tax. If it made \$6,000 net income, it paid a tax on \$3,000, which of course was equivalent to paying half the standard rate on the whole of its net income. So that in a way specific exemptions in the case of small corporations does bring about certain automatic graduations, you might say, in respect to the tax on their entire net income. Now what is proposed in the bill is to substitute for the existing 15¼ percent—

The CHAIRMAN. Now, is that the present rate on corporations of \$25,000 capital, that \$3,000 of profits is exempt?

Mr. PARKER. No, Senator; there is no exemption. I just pointed out that they did that up until 1932. That was in the 1928 act.

The CHAIRMAN. All right. Then we changed it in 1932 and there is no exemption now.

Mr. PARKER. There is no exemption whatsoever now.

Senator GERRY. Was not that exemption put in originally in order to even it up with the copartnership? Do you remember the old controversy that Senator Jones, of New Mexico, brought up in the old days, in 1917 and 1918, in regard to equalizing the tax between the copartnership and a corporation?

Mr. PARKER. It is true, of course, under certain conditions, Senator, that the small corporation is at a disadvantage with the partnership. For instance, if we should go into partnership and make \$5,000, we would both take up \$2,500 on our income-tax return, and if that was all the income that we had, neither of us would pay any tax; if we were both married our \$2,500 exemption would take us out, whereas the corporation that made \$5,000 would pay 13¾ percent on that amount. However, it is not as bad as it looks because of the fact that a corporation can deduct officers' salaries, and unless we were simply investors and could not draw a salary from the corporation, if we both had a \$2,500 salary from the corporation, of course the corporation would have no net income and pay no tax, and we would take up the \$2,500 salary, and we would pay no tax on that, because the exemption would eliminate that amount from taxable net income. However, there is some discrepancy in many cases.

Senator GERRY. As I understand, that was the basis for the changes made in exemption.

Mr. PARKER. Now the bill proposes in lieu of the 13¾-percent rate to place a tax of 13¾ percent, one-half percent less than the standard rate, on the first \$15,000 of the net income of the corporation, and then to apply a rate of 14¼ percent, which is of course one-half of a percent more than the present standard rate.

Senator GORE. How is that?

Mr. PARKER. They propose to put a 14¼-percent rate on the portion of the net income in excess of \$15,000.

The CHAIRMAN. In other words you increase it on the amount above \$15,000?

Mr. PARKER. Yes, Senator. What that will amount to, though, is this: Corporations having a net income of over \$30,000 will pay more tax; corporations having a net income of less than \$30,000 will pay less tax. That is, of course, because the first \$15,000 is taxed at 13¾ and the next \$15,000 at 14¼, so that at the \$30,000 point you reach a balance and you arrive at an average rate of 13¾, which is what it is now.

The CHAIRMAN. Now read what the President said with reference to that proposal, his suggestions on that.

Mr. PARKER. The President's proposal on that point is rather long, and I think it will be sufficient to quote his definite recommendation, which really covers the matter:

I, therefore, recommend the substitution of a corporation income tax graduated according to the size of corporation income in place of the present uniform corporation income tax of 13¾ percent. The rate for smaller corporations might well be reduced to 10¾ percent, and the rates graduated upward to a rate of

16¼ percent on net income in the case of the largest corporations, with such classifications of business enterprises as the public interest may suggest to the Congress.

The CHAIRMAN. Well, you haven't carried that suggestion out at all, have you?

Senator COSTIGAN. The bill does not leave the maximum as suggested by the President.

Mr. PARKER. The bill graduates the rate, and of course the graduation is very slight.

The CHAIRMAN. Well, you start at 13¼ percent and the President suggests 10¼ percent.

Mr. PARKER. The President suggested going down 3 percent on the small incomes, and he suggested going up to 16¼ percent on the large net incomes. The Ways and Means Committee went down only one-half of 1 percent on the small corporations, and went up one-half of 1 percent on the large corporations.

The CHAIRMAN. Why was that change made?

Mr. PARKER. Of course, I cannot speak for the committee but it is fairly obvious, I think, that inasmuch as the Ways and Means Committee also recommended an excess-profits tax that they felt that this excess-profits tax was a better test of ability to pay than the mere size of the net income.

The CHAIRMAN. Well, did the President, in his message, suggest anything about excess-profits taxes?

Mr. PARKER. No, Senator, he did not suggest anything about excess-profits taxes. Of course he mentioned the ability to pay, and those other principles.

The CHAIRMAN. His suggestion was a graduated corporation tax of 10¼ to 16¼ percent?

Mr. PARKER. That is correct.

The CHAIRMAN. The House committee recommended instead of that 13¼ and 14¼?

Mr. PARKER. Graduated.

The CHAIRMAN. Graduated between those, with an excess-profits tax on top.

Mr. PARKER. That is correct, Senator.

Mr. GERRY. Mr. Parker, why do they start at \$15,000?

Mr. PARKER. The graduation was so slight that it was necessary to start at \$15,000 in order to bring in a substantial amount of income. This proposal is estimated to produce \$15,000,000.

Senator GORE. This graduated tax?

Mr. PARKER. This graduated corporation tax.

Senator GORE. Let me ask you this, Mr. Parker. I do not know whether you care to express an opinion on the matter of policy, but do you not think an excess-profits tax is a better test of standards than a graduated tax on corporations?

Mr. PARKER. We have never had a graduated tax on corporations. We have had an excess-profits tax.

Senator GORE. A graduated tax on corporations does not mean that there is, necessarily, an ability to pay; does it?

Mr. PARKER. There is practically no history on the graduated corporation tax. I found a couple of Provinces in Canada that had something like this. On the first \$1,000 they tax it 1 percent; on the second thousand dollars they tax it 2 percent, on the net income, and

so on. When they got to \$20,000, they taxed all over that at 20 percent. That is, of course, rather different from going up with graduations to \$1,000,000. It has the same general effect as a specific exemption of \$3,000 or \$4,000.

Senator GERRY. Did not we have this up in the committees in war time, in reference to the excess-profits tax?

Mr. PARKER. I remember it was discussed. I do not remember that it was ever in bill form.

Senator GERRY. I think it was very thoroughly discussed. Of course, on this thing, if you are depending upon the amount of the tax, if a man happens to own stock in two or three corporations, he gets the advantage of the same amount of money.

Mr. PARKER. I do not think he would under these small graduations. That would be true if the graduations were large, although I would like to point out to the Senator that I do not think there is much danger of evasion by creating a lot of corporations out of one corporation, and the reason for it is this: We did not permit a consolidated return except in the case of railroad companies. Now, when a corporation splits up into a lot of corporations, unless they are very wise and look into the future, which is almost impossible to do with certainty, there are bound to be some companies with a loss and some companies with a profit. Now, if they split up into all these companies, under the existing law, the loss of one company cannot be deducted against the profit of the other, and if they are not very careful in splitting up into a number of corporations they are going to find their taxes increased instead of decreased.

Senator GERRY. Yes; but suppose an individual has an interest in two or three absolutely diverse, separate corporations, and they were all paying a less tax, the tax only amounts to 1 percent; it does not amount to much, if there is a deep differential in the tax. Even if he owns two or three corporations, the taxes are very much less than if he owned one.

Mr. PARKER. I think it is certainly true, Senator, and if you are going to graduate on corporate net incomes you could hardly go to any such extent in graduation as we do in the case of surtaxes on individuals. For instance, if you started out with a 4-percent rate and graduated it to 50 percent, then of course that would magnify the inequalities, and it would be almost impossible to justify any such graduation.

Senator GERRY. In other words, it is not a very sound basis.

Mr. PARKER. The graduation in the bill gives a certain small amount of relief to the corporation with a small net income which, as you point out, is at some disadvantage with the partnership. This is one justification for the proposal.

Senator GORE. My point is this: In theory, at least, the ability to pay ought to be the general standard of the person's tax. Does the graduated tax on the income of corporations have any necessary relationship with the ability to pay?

Mr. PARKER. I think it has some relation to the size of the corporation on the average.

Senator GORE. Suppose a corporation has \$10,000 capital invested and another corporation has \$1,000,000 invested, and they had the same net earnings, it looks to me like the return to those who put up the money would be different.

Mr. PARKER. Well, of course, here is one answer that might be made to that: It might be said why should not an individual take into account his invested capital? Suppose an individual has \$10,000,000 invested and only makes \$100,000, why should he pay so much more tax than a man that has \$10,000 invested, and makes \$50,000? That same argument might be raised in the case of the individual.

Senator GORE. Did we not take care of that very case by offering an increased tax where the capital invested bore a small relationship to the income?

Mr. PARKER. You mean in the case of the corporation. We never did it in the case of the individual, we never attempted to get his invested capital.

Senator GORE. Only on corporations?

Mr. PARKER. Only on corporations. Excess-profit taxes of course were based on the invested capital. The tax depended on the relation between the net income and the invested capital.

Senator GORE. That is what I had in mind. The excess-profits tax was based more on the ability to pay than the income.

Mr. PARKER. That, of course, is one of the taxes proposed in this bill by the Ways and Means Committee, only it is on a somewhat different basis than that which was actually used during the war period.

Senator BYRD. Where are you, Mr. Parker?

Mr. PARKER. On page 4, section 102. We were discussing the graduated income tax on corporations.

Now there is a surprising number of corporations that have net incomes of less than \$15,000, and there is a surprisingly small number of corporations that have a net income of more than \$15,000, under present conditions.

The CHAIRMAN. Well, can a corporation ever pay more than 15½ percent under this tax?

Mr. PARKER. The corporation which files a separate return can never pay more than 14¼ percent upon its entire net income.

The CHAIRMAN. What does it mean when it says—

but the tax at such rate of 15¼ per centum shall be considered as imposed by section 13 (a).

Mr. PARKER. Subsection (b) on page 5, Senator, is a separate proposition, in a way. That is to take care of the consolidated return in the case of railroad companies. You will recall that in the Revenue Act of 1934, as it passed the House, a consolidated return was permitted to all corporations. That bill was reported out from this committee providing for the consolidated return. On the floor of the Senate the consolidated return was stricken out, except as to railroad companies, and that was agreed to in conference, and became law. Now we had provided, or the House had provided, and the Senate Finance Committee had provided, that if corporations filed consolidated returns they could pay 2 percent more tax. That is the way it was in the law, 2 percent more.

The CHAIRMAN. You are familiar with that, but as I read this (b), "Section 141 (c) of the Revenue Act of 1934 is amended by striking out", and then you do not add this excess profits tax on this corporation tax that is subscribed to in (a) and the railroad companies in section 102.

Mr. PARKER. What this bill will do, in simple words, in the case of railroads which file consolidated returns, is that they will pay 15¼ percent on their entire net income, just exactly as they do today.

The CHAIRMAN. Is there any limitation on other corporations different from the railroads as to the amount that they can pay, that is not limited to 15¼ percent?

Mr. PARKER. Well, they cannot pay over 14¼ percent, because that is the maximum rate for all other companies.

The CHAIRMAN. They cannot pay over 14¼ percent?

Mr. PARKER. No, Senator.

The CHAIRMAN. There is no excess-profits tax on the corporation?

Mr. PARKER. Oh, I beg your pardon. I mean leaving out of consideration excess-profits taxes. Both the railroad and the corporation would be subject to this excess-profit tax. We haven't come to that yet.

The CHAIRMAN. That is in another section altogether?

Mr. PARKER. That is in another section altogether, yes, sir.

Senator KING. Section 102 (a) and (b).

Mr. PARKER. Subsection (b) is to take care of the consolidated returns in the case of railroads. They did not have to file consolidated returns. If they did not file a consolidated return they can come in and be subject to this graduated tax of 13¼ and 14¼ just the same as any other corporation, but if they did file a consolidated return, then they pay 15¼ percent on their entire net income, just the same as they do today.

Senator KING. Then it is subject to excess profits taxes in addition?

Mr. PARKER. They are subject to excess-profits taxes if they make over 8 percent. I do not think many railroads make over 8 percent.

Senator KING. Is the limitation on other corporations as well as railroads?

Mr. PARKER. Yes. No corporation will pay the excess-profits tax unless it makes over 8 percent on the adjusted declared value of its capital stock.

Senator BYRD. How high is that fixed, Mr. Parker?

Mr. PARKER. If you will pardon me, Senator, if you will just let me get rid of section 103 and 104 you will see on page 6 we will come to excess-profits taxes.

Sections 103 and 104 can be disposed of in a very few words. We have special provisions in our revenue act governing insurance companies, and we restate the percentage of tax paid in those sections which is 13¾ percent, and of course following out the scheme of the construction of the act we simply make the insurance companies pay the graduated tax of 13¼ and 14¼, just the same as any other corporation. In other words, the insurance companies are taxed at the same rate, and will be subject to the same change as any other corporation.

Senator KING. It was reduced from 13¾ to 13?

Mr. PARKER. The insurance companies will pay 13¼ on the first \$15,000 of their net income, and 14¼ on the balance over \$15,000.

Senator KING. On line 15 of page 5 you say—

are amended by striking out "13¼ per centum of".

Mr. PARKER. If you had the Revenue Act of 1934 before you and looked up that section, you would strike out the 13¾ per centum and insert in lieu thereof, "a tax at the rates specified in section 13 upon."

Then section 13 is over here in subsection (a). Section 102, you see, amends section 13 (a), and these graduated taxes are put in section 13. It is simply a necessary correction, that is all, unless you want to tax insurance companies at some different rate than the other corporations. If you tax them the same as other corporations as at present, then you will have to make this change, so they will be subject to the new system, just the same as other corporations.

Senator KING. Have you taken into consideration the criticisms which have been leveled against the bases of taxation of insurance companies in past hearings, in framing this bill, and in dealing with the tax which was imposed on the insurance companies?

Mr. PARKER. We did not, Senator, go into the method of taxing insurance companies. We left that in status quo. Insurance companies do get a rather large deduction, amounting to 3¼ percent of the mean reserve. Of course that does not mean anything to other corporations, but it is a very substantial reduction, and substantially reduces the tax of insurance companies. However, it may be justified when we look at the mutual character of insurance companies. Practically all insurance companies conduct their business now on a mutual basis, and they have so many people interested in their earnings that it may be perfectly proper that their tax should be on a lower basis.

Senator KING. There is a little favoritism there.

Mr. PARKER. Well, it is computed that there are about 65,000,000 people that have policies of insurance. That is one-half of our population. There are over 130,000,000 policies of insurance in force. Of course when you come to industrial insurance, and all that, a tax does bear rather heavily on the insurance company, when it is carried on in a mutual character. That is going to affect the cost of insurance to all these small policyholders.

Senator KING. Proceed.

Mr. PARKER. Now section 105 of the bill amends the Revenue Act of 1934 and provides for a graduated excess-profits tax in lieu of our present excess-profits tax, which is imposed at the flat rate of 5 percent. This excess-profits tax cannot be fully understood unless we recall what was done in connection with the capital-stock tax imposed by the Revenue Act of 1934. Under that act we gave a corporation the right to declare the value of its corporate stock. We put no limitations on the corporation. They could declare any value that they saw fit, but having once declared that value they were bound by it, except as to bona fide additions to or subtractions from their capital.

Senator KING. Was not there some understanding or some provision in the law that the declared value must have some relation to the actual market value, to its intrinsic worth?

Mr. PARKER. No, Senator, there was no provision that provided for it at all, but we put in this 5 percent excess-profits tax in 1934, which operated automatically to make the corporations declare a fair value, at least fair insofar as value could be predicated upon future expected profits. After all, a corporation that will never make any money is not worth very much.

The CHAIRMAN. Well, that capital-stock tax has worked all right, hasn't it?

Mr. PARKER. I think it has worked very favorably. It has been a good revenue producer. It produced \$80,000,000 under the National Industrial Recovery Act. It will produce this year \$91,000,000. Of course the corporations have had two chances to declare a new value. That is, they had the original declaration in 1933 and then when we reimposed the tax in 1934 we gave them another new declaration.

Senator KING. Were there many changes in the revaluation?

Mr. PARKER. There must have been about 10 or 11 percent increase, because the receipts went up from \$80,000,000 to \$91,000,000. They did come up with the values.

The CHAIRMAN. If they did not come up with the value, they would have to pay that much more?

Mr. PARKER. That is right, in respect to the excess-profits tax.

The CHAIRMAN. That is one of the automatic propositions.

Mr. PARKER. If they did not come up with the value, they would have had to pay 5 percent excess profits. If they paid that tax, it would cost a lot more than if they had paid on a reasonable value of the capital stock.

Senator BYRD. Is there any relation between the original value of the capital stock and this adjusted declared value?

Mr. PARKER. Yes; the adjusted declared value is simply the original value adjusted down to the date of the year for which you are computing the tax by bona fide additions to capital or subtractions from capital. For instance, suppose you declare a fair value of your capital stock originally at \$1,000,000, and then you issue \$200,000 more of stock for cash, that would be an adjustment. You would add the \$200,000 to your \$1,000,000, and you would have \$1,200,000. That would be your adjusted declared value.

Senator BYRD. That is assuming you put the \$200,000 in some improvements?

Mr. PARKER. No, it would be in cash, as long as it was bona fide paid in. You might have declared a value of \$1,000,000 and a part of it possibly would have been represented by surplus, and then you declared that surplus out by way of a dividend. Then you would be obliged to reduce that value, having that much less capital employed.

Senator BYRD. This is the book value, isn't it?

Mr. PARKER. Some companies doubtless declared book value but there was no requirement in the law whatsoever that they had to declare any specific value.

Senator BYRD. It is not the same value as the capital-stock value?

Mr. PARKER. In respect to that original declaration they were not bound by their books at all, but from that point on then their books would be practically controlling as to these additions or subtractions from that basic figure.

Senator BYRD. Do I understand then that you take the capital stock value as the basis?

Mr. PARKER. That is the basis for this excess-profits tax in the bill; yes, sir.

Senator BYRD. That is a very remarkable thing, because that was fixed entirely at the discretion of the corporation, without regard to the books.

Mr. PARKER. That is correct, but on account of the excess profits tax it had a relation to value. One test of value is the future earning

possibilities of the corporation, and of course all of these systems have hard cases. Our old excess-profits tax had plenty of hard cases.

Senator BYRD. The corporation had the right to value its property at anything it pleased?

Mr. PARKER. That is right. We asked them to put a fair value on it, that is all.

Senator BYRD. I asked someone a question on that right before that committee, and they replied then that the corporation could place any value it pleased on it, without regard to the investment, without regard to actual value. Do I understand you are going to take that valuation as the basis of this excess-profits tax, too?

Mr. PARKER. Yes, Senator.

Senator KING. We had an excess-profits tax, Senator, on that declared valuation, of 5 percent.

Senator BYRD. That is very much less excess-profits tax than you have now.

The CHAIRMAN. That excess-profits tax was what?

Mr. PARKER. It was 5 percent of the amount of net income in excess of 12½ percent of the adjusted declared value.

Senator BYRD. Are you going to give the corporation a chance to have a new value, in view of these new rates?

Mr. PARKER. The bill does not provide for that, Senator.

Senator BYRD. Every corporation, as I understand it, fixed the value in proportion to whether or not they had to pay the 5-percent excess-profits tax, and fixed it sometimes at much more than the value of the property, and perhaps at other times fixed it at less than the value of the property. You change the basis entirely. You have gone up to 25 percent. I think they would have a right to a new valuation.

Mr. PARKER. I simply want to point out, Senator, there is very much to be said, of course, for giving them a new valuation, but if you do that you will cut your receipts under the proposed excess-profits tax very materially, unless you adopt an equalizing scheme, for instance, like increasing the capital-stock tax from \$1 a thousand to \$1.50 a thousand, which would bring in about \$50,000,000, and then put on your excess-profits tax. That would be probably an optional plan.

Senator BYRD. Doesn't this destroy the whole theory of a real excess-profits tax? The other brought in only \$6,000,000. The theory of the excess-profits tax is if a corporation earns a great deal more on its investment than some other corporation does, then it should pay a larger tax than the other corporation.

Mr. PARKER. It was thought, Senator, when the capital-stock tax was imposed, that the corporation would come in honestly and pay on a fair value of their stock.

Senator BYRD. But they haven't done that in the valuations.

Mr. PARKER. They were supposed to do it, because we told them in the original law, having declared that value we would never let them change it. Therefore, if they looked ahead to the future for 10 years, it seems to me they should put on a fair value.

Senator BYRD. You also told me that they had a right to put on any valuation that they pleased.

Mr. PARKER. In the beginning they did, but not afterward.

Senator BYRD. I know of a corporation that I happened to be interested in, and we were told by the Government we could fix any value we pleased on it. So if you take that value, you are not carrying out the real theory of an excess-profits tax.

Mr. PARKER. The alternative is to compute the invested capital, but that was a terrific administrative task, and when we got it all done in about 25 percent of the cases we had to give special relief by special assessments because the results did not work out equitably. The system was an advantage to the new corporations that had put in their money during a more inflationary period, and were higher capitalized in comparison to the old corporations which were often capitalized at a very small amount. So the old excess-profits tax had very many inequalities.

Senator KING. Before we accepted this philosophy which underlies the former bill, measuring excess profits, were there not some attempts made to calculate the advantages and disadvantages, and it was generally believed by our experts—and that was the reason we accepted this philosophy—that permitting them to declare the value, and then impose upon them not only the regular tax but the 5 percent excess-profits tax, would be substantially the same in revenue, and would be a little more equitable than the other theory?

Mr. PARKER. That was the general thought, Senator, and the detailed figures reported do not seem to indicate that in the aggregate at least there has been any very great hardship done. For instance, we have had the capital-stock tax before, and when we had it before we went in every year and actually valued the stock of these corporations at the current market value. Now, at the same rate of tax in those days, we got in about \$80,000,000. So the present \$90,000,000 does not look bad. Also in the statistics of income, looking up the corporate balance sheets, we find the corporations show a net worth of around \$100,000,000,000. You see a tax of \$90,000,000 at one-tenth of 1 percent represents a declared value of \$90,000,000,000, and that figure, checked from our statistics, seems to be a rather fair figure.

Senator BYRD. Senator King's question related to the 5 percent tax which is not graduated. Now you have a graduated tax that goes up to 20 percent, which entirely changes the situation.

Mr. PARKER. Yes; it changes the situation.

Senator BYRD. What we are proposing to do is to put an excess-profits tax on a fictitious valuation. I suppose many of these valuations are fictitious. They are not illegal, because the Government has told them they can value anything they please, they can determine themselves whether to pay the capital stock tax or pay the 5 percent excess-profits tax. I think it ought to be a regular, real value.

Senator CONNALLY. Mr. Parker, the invested capital basis, is not the basis we had in 1921, in regard to excess-profits taxes?

Mr. PARKER. Yes; from 1917 to 1921 we had the invested capital basis.

Senator CONNALLY. That tax produced a very large revenue, did not it?

Mr. PARKER. Yes; that tax produced a very large revenue. I think I have the figures here, Senator.

Senator CONNALLY. The reason I asked you that is because I introduced an amendment to the bill in the Senate 2 weeks ago prac-

tically reenacting the law of 1921, which carries a greater rate than this bill, but it gets the money.

Mr. PARKER. I have the figures showing the revenue from the excess-profits and war-profits taxes, which, of course, was in addition to the normal income tax on corporations. The figures are as follows:

For 1917 it was \$1,638,000,000.

For 1918 it was \$2,505,000,000.

For 1919 it was \$1,431,000,000.

For 1920 it was \$988,000,000.

For 1921 it was \$335,000,000.

Senator KING. Was that all derived from excess-profits taxes, or was it those plus any other taxes?

Mr. PARKER. Those are just excess-profits taxes. In 1921 we had a bad year.

Senator CONNALLY. In the 1921 act, those rates allowed the corporations a net profit of 8 percent?

Mr. PARKER. That is right.

Senator CONNALLY. Then it took 20 percent on the next 20. In other words, after they made 8 percent, then on the next 20 percent above that they paid 20 percent, and on the second 20 percent—

Mr. PARKER. Then over that they paid 40 percent. There were just two rates, 20 and 40.

Senator CONNALLY. That brought in, even in 1921, \$350,000,000?

Mr. PARKER. \$335,000,000.

Senator CONNALLY. And now that was based, as brought out by Senator Byrd, that was based on the invested-capital basis, wasn't it?

Mr. PARKER. That is correct.

Senator CONNALLY. In other words, that actually was the corporation's investment.

Mr. PARKER. Yes; they took the original invested capital, then figured the surplus from the time of organization down to date. They went through a lot of computation, but that represented the invested capital.

Senator WALSH. What was the normal corporation tax for those years?

Mr. PARKER. The normal corporation tax in 1918 was 12 percent. In the subsequent years it was 10 percent.

Senator WALSH. The corporations paid that general tax, then those that made the profit over 8 percent had to pay an excess-profits tax?

Mr. PARKER. That is correct.

The CHAIRMAN. As a matter of fact the normal tax was lower in that year.

Mr. PARKER. The rate went up from 10 percent to 12½ percent in 1922, and for reason that we took off the excess-profits tax in that year.

The CHAIRMAN. Did the committee over there, Mr. Parker, give any consideration to this matter in connection with this report, that it would be wiser to increase the excess-profits tax in the capital stock revenue?

Mr. PARKER. That is what they have done here. They increased the excess-profits tax.

The CHAIRMAN. And you do not allow them, if we do that, to declare the value upon which they are to pay the tax?

Mr. PARKER. We do not allow them to declare a new value.

The CHAIRMAN. In the capital-stock tax we allowed over 12½ percent to pay one-tenth of 1 percent?

Mr. PARKER. No; 5 percent.

The CHAIRMAN. Five percent over 12½ percent.

Mr. PARKER. The capital-stock tax is one-tenth of 1 percent.

The CHAIRMAN. The only difference between that and this you have allowed in that case a new declaration of capital stock?

Mr. PARKER. We only allowed it the first year, Senator.

We did not propose to allow it every year.

Senator LA FOLLETTE. By and large, Mr. Parker, was not the inducement provided by these two taxes for a corporation to really declare its fair value?

Mr. PARKER. It was hoped, of course, that they would declare a fair value, looking into the future, and in the light of the uncertainties of the future that they would feel it a good policy to declare today what their corporation was actually worth.

Senator BYRD. Why did not the law provide for that?

Mr. PARKER. Because it would force us to go in and make a valuation, which is a very difficult proposition, valuing every corporation in the country.

Senator KING. When we attempted to value the property of the corporation as a basis of taxation, you recall, do you not, Mr. Parker, that in the investigation conducted by Senator Couzens and several others, including myself, we had one illustration there that shows the difficulty.

One set of Government officials valued the property at so much and another valued it at another amount. There was a difference of seven or eight hundred millions of dollars, as I recall it. It was a stupendous sum, and it made a difference in the taxes of millions, in fact more than ten or fifteen million dollars. That was one of the illustrations that I recall, that induced us to try to find some rational basis upon which there might be an equitable tax imposed, the tax having some relation to the value of the property and not to the income.

Mr. PARKER. Well, of course, Senator, the capital-stock tax, being not according to the ability to pay, is considerably helped if the person does have the opportunity to declare a value. For instance, Senator Gerry, I think, has mentioned to me some factory or business, that probably never would make any money. A big mill building may have cost \$5,000,000, but due to the condition of the business, even though the books might show a value of \$4,000,000, nobody would give 10 cents for it, because there is no money to be made in that particular business. There are many businesses that are certainly out of luck and will probably never come back as profitable companies.

Now a capital-stock tax based on the book value or invested-capital value is in many respects unfair. They ought to be allowed to chop down the value and only pay capital-stock taxes in a nominal amount, when they just run the business to keep a few people employed.

The CHAIRMAN. If they make a lot of money, they would have to pay?

Mr. PARKER. They would be tickled to death if they made 1 percent over 8 percent, and they would not have to pay any excess profits until they made 8 percent. These rates only go to 20 percent, which is an entirely different proposition from going to 40, 60, or 80 percent, like they did during the war.

Senator KING. Have you any figures there, Mr. Parker, showing the number of corporations in the United States today, or at the time of the last census?

Mr. PARKER. Yes, Senator. All corporations are required to file income-tax returns.

Senator KING. What is the number of them.

Mr. PARKER. I think we have an accurate figure in respect to that.

Senator KING. Three hundred and some odd thousand, isn't it?

The CHAIRMAN. If they pay no income tax, they would not be classified in that number, would they?

Mr. PARKER. Yes, they have to file a return. Corporations have to file a return, whether they make any income or not. In 1932 there were 508,636 corporations filing a return.

Senator KING. Now, how many of those were out of the red?

Mr. PARKER. Only 82,646 made a profit, about 15 or 16 percent.

Senator CONNALLY. Well, they would not pay any taxes if they did not make a profit?

Mr. PARKER. They would have to pay the capital stock tax.

Senator CONNALLY. They would pay the capital stock tax, I understand, but not excess profit taxes. How much do you estimate we will get from this excess profits tax in the bill?

Mr. PARKER. \$90,000,000 to \$100,000,000.

Senator CONNALLY. At a rate of 5 percent?

Mr. PARKER. It starts at 5, then goes to 10, 15, and 20. It is 5 percent on amounts of net income in excess of 8 percent of the adjusted declared value, and not in excess of 12 percent. Then, 10 percent on the profits between 12 percent and 16 percent; 15 percent on the profits between 16 percent and 25 percent, and 20 percent on profits in excess of 25 percent of the adjusted declared value.

Senator CONNALLY. 20 percent?

Mr. PARKER. 20 percent on profits in excess of 25 percent of the adjusted declared value.

Senator WALSH. What is the normal corporation tax?

Mr. PARKER. The normal corporation tax, graduated under this bill, is from thirteen and one-quarter percent on the first \$15,000 of net income to fourteen and one-quarter percent on the amount of net income over \$15,000.

Senator WALSH. Did the committee give consideration to adopting the tax that was levied during the war on corporations?

Mr. PARKER. It was discussed to some extent, Senator.

Senator WALSH. I understood the Senate was in favor of it.

The CHAIRMAN. Did the Treasurer give any views at all on that proposition, with any recommendation?

Mr. PARKER. No, Senator, the Treasury made no recommendation on the excess-profits tax.

Senator KING. Coming back to the 15 percent of the corporations, the only ones that had any income at all, you expect to get \$90,000,000 from the excess-profits tax?

Mr. PARKER. Of course those figures that I gave you, Senator, were for 1932. There have been great fluctuations. There have been considerable improvements in the situation. Maybe I can find the 1933 figures here.

Senator KING. What is the aggregate amount that you expect to collect from all corporations?

Mr. PARKER. Under this bill?

Senator KING. Under this bill.

Mr. PARKER. About \$100,000,000 on excess-profits tax, \$15,000,000 on the graduated corporation tax.

Senator KING. And the normal, does that include the normal?

Mr. PARKER. That includes everything; yes, sir. Fifteen million dollars is the graduated tax in place of the one normal rate.

Senator KING. That is \$115,000,000?

Mr. PARKER. \$115,000,000.

Senator KING. That you expect to collect from corporations?

Mr. PARKER. That is correct. Then we expect to get about \$45,000,000 from individuals under the surtax.

Senator GERRY. How much?

Mr. PARKER. \$45,000,000. And we expect to get about \$110,000, from the inheritance and gift taxes, making, I believe, \$270,000,000.

Senator WALSH. I have seen some figures some place showing the overwhelming number of corporations earning less than \$25,000 a year. Do you know what those figures are?

Senator KING. You mean gross receipts?

Senator WALSH. Yes; for income tax purposes. The number that have had over that sum was a very, very small number.

Senator KING. Assume that the number of corporations for this year would be 15 percent, then out of that number you say there is only a small proportion of the 15 percent that earn \$25,000?

Senator WALSH. Yes.

Mr. PARKER. I have the figures for 1932. In 1932 out of this 508,000 corporations only 82,646 reported taxable net income. Now out of that 82,646 there were 76,216 that showed taxable net incomes of less than \$25,000, leaving only 6,430 corporations showing net incomes of over \$25,000. That is only 8 percent of the corporations reporting net income, that had a net income in excess of \$25,000.

However, the reason we obtain revenue by this graduation is this: Seventy-three thousand corporations that had net incomes of less than \$25,000 only had a total aggregate net income of \$205,000,000, whereas the 8 percent of the corporations which had net incomes of over \$25,000 reported an aggregate net income of \$1,947,000,000. In other words, that small number of corporations has 90 percent of the net income.

Senator WALSH. That shows the concentration of business.

Senator GERRY. What was the number of stockholders that you had in that 8 percent of the corporations?

Mr. PARKER. I haven't those figures, Senator Gerry. In fact I have looked for those figures and I am unable to find authentic figures on that point. I do not know the figures. I have been unable to find the total number of stockholders in the United States.

Senator GERRY. But that is important.

Mr. PARKER. It is important. Of course we know the number of stockholders in some of the large corporations. I haven't the figures here. I understand the American Telephone & Telegraph Co. has something like 400,000 stockholders. The Pennsylvania Railroad has a very large number of stockholders, and there are some corporations that we know have a large number of stockholders.

Senator GERRY. Why were not you able to obtain those figures, Mr. Parker?

Mr. PARKER. It has been estimated, but I haven't the figure with me.

Senator GERRY. I wonder if you can get those, just the estimate, and then put them in the record for the future.

Mr. PARKER. I will attempt to do it, at least I will try to get an estimate of it.

The CHAIRMAN. Why did the committee over there discard the President's suggestion with reference to this corporation graduated tax and restrict as they did, refraining thereby from carrying out the President's suggestion and adopting the excess-profits tax? Were there any injustices, or what was it? Just tell the committee frankly what it was.

Mr. PARKER. I believe—this is my personal opinion—that the committee thought the excess-profits tax was a fairer tax than the graduated corporation tax, but that they were willing to adopt the principle as a trial, to see how it would work, but they did not want to go very far in that direction at the present time.

The CHAIRMAN. Do you mean to tell this committee that over there at the Ways and Means Committee the Treasurer did not furnish all these figures, facts, and estimates?

Mr. PARKER. They furnished a lot of estimates; yes, Senator; but at the time the Treasury was asked for estimates, there was nothing said about excess-profits tax, of course.

The CHAIRMAN. How about the corporation tax?

Mr. PARKER. They furnished the estimates on that.

The CHAIRMAN. How much could they raise out of the corporation tax, carrying out the President's suggestion?

Mr. PARKER. They could raise about \$102,000,000; \$100,000,000, or \$102,000,000, I think the Treasury estimate was.

The CHAIRMAN. Was your estimate about the same?

Mr. PARKER. Yes, sir.

Senator BYRD. How much does the excess-profits tax raise?

Mr. PARKER. Approximately \$100,000,000.

Senator BYRD. That is in addition to what you kept out?

Mr. PARKER. Yes; that is additional.

Senator CONNALLY. Have you got any estimate as to what the old rate that you suggested awhile ago—the 20 percent and 40 percent—would produce?

Mr. PARKER. Today?

Senator CONNALLY. Yes.

Mr. PARKER. I have never made a detailed estimate. The best guide that I know would be that in 1921 we received from that source \$335,000,000.

Senator CONNALLY. I thought probably you made the estimate here on the basis of 5, 10, 15, and 20; you said that would get \$100,000,000. I was wondering if you estimated from that what the rate of 5 percent, for instance, would give.

Mr. PARKER. Of course, you will not get many in the 40-percent bracket.

Senator CONNALLY. No; but you would get enough of them in the 20-percent bracket.

Mr. PARKER. Yes. Of course, even the \$100,000,000 estimate is based on future conditions, not for last year but for next year, and we gave some weight to improving business conditions. Of course,

excess-profits taxes are very sensitive to business conditions; and if we take into account a reasonable increase in business profits, I imagine the old invested-capital-stock tax would bring in \$300,000,000, at least.

Senator CONNALLY. It would bring in \$300,000,000 instead of \$100,000,000?

Mr. PARKER. Yes. That is a rough guess. I see no reason why it would not.

Senator WALSH. Returning to the chairman's question, this subject was discussed at great length and much consideration was given to it by the Ways and Means Committee. Did they not finally reach the conclusion that the fairest and best and most just way to levy taxes on a corporation was a graduated tax upon profits rather than a graduated tax upon the mere income without regard to profits of the corporation?

Mr. PARKER. That is correct, Senator.

Senator WALSH. And is not that your own opinion?

Mr. PARKER. I believe for a revenue producer the excess-profits tax is much preferable; but I do not propose to criticize the graduation in this bill, because I think there is a reason for reasonable graduation. I think reasonable graduation can be defended on the ground that the small corporation is at a disadvantage to a small partnership.

Senator KING. Is not it a fact that many of the small corporations, with reference to the capital stock invested, earn a much larger return than many of the large corporations?

Mr. PARKER. Oh, that is true. I have seen the return of a corporation with over a billion dollars gross income have \$25,000 net.

Senator KING. Is not it a fact that the large number of corporations in the United States that make returns of profits are corporations whose assets are, perhaps, under \$100,000, and whose capital would be less than \$100,000, and yet the returns upon the invested capital, or upon computation of the value of the property, is greatly in excess, in percentage, than in the returns upon many of the larger corporations in the United States?

Mr. PARKER. I think the small corporation is rather more likely to have a higher rate of profit than a large corporation, which has so much more overhead, but which probably adjusts its business and equalizes its affairs better than a small corporation can.

The CHAIRMAN. Mr. Parker, we have got just a few minutes left. Won't you go down to the comparative features of this bill?

Mr. PARKER. There is just one thing more I ought to mention about these amendments in title I. The bill provides for no retroactive taxes. It provides that the surtax will not be payable except for taxable years ending after December 31, 1935. That means that the calendar year returns for 1936 will be the first to bear the increased surtaxes.

Senator LA FOLLETTE. Why was not that made retroactive?

Mr. PARKER. The committee believed it was so late in the year, more than half of the year having elapsed, that they should not make the taxes retroactive.

Senator LA FOLLETTE. The 1932 Revenue Act did not go into effect until along in July, did it?

Mr. PARKER. That is true, Senator. Still, I think there is some distinction between the 1932 act, the 1934 act, and this act. In both

of those cases that legislation was gotten under way in December or January. People were put on notice of the proposals. They knew there was a tax bill, they knew there were high rates proposed, and so on, and we passed a bill either in May or June, but all that time the public had been on notice that the transactions that they were making currently might be subject to a higher rate of tax. Now in the case of this bill we had no intimation of this thing until June 19, in the President's message, and it is almost just yesterday, you might say, for the first time, that the public knows that they are going to have the high rates definitely. Now it is pretty hard for a man, for instance, that has made a big transaction here in February, March, or even as late as June, to find he has to pay 75 percent tax on that instead of 59 percent. There is that much distinction.

Senator KING. Did not they also take into account the fact that it is expected and supposed, whether rightly or wrongly, that business is on the upward curve and that they ought to permit a little chance for a business man to get rehabilitated and get some profits before slapping on those higher rates?

Mr. PARKER. The same thing is provided for in the graduated income tax for corporations. That does not take effect until the calendar year 1936, and in the case of this excess-profits tax, that affects income-tax taxable years ending after June 30, 1936. We have to have a little different rule there, because the capital-stock tax returns are all filed on the same date, and the effect of that rule is that on calendar-year returns—and most corporations file calendar-year returns—they first pay the excess-profits tax for the calendar year 1936, but there are a few fiscal-year returns that might pay some little tax on 1935 transactions, but they won't pay any excess-profits tax on any transactions consummated prior to August 1 of this year.

Senator WALSH. Are there any provisions in this bill that have to be taken into consideration?

Mr. PARKER. I did not quite get your question?

Senator WALSH. Are there any provisions in this bill that are affected in the returns of the present calendar year that begins on December 31?

Mr. PARKER. No; none of the provisions in title I, but the inheritance tax and gift tax takes effect with the date of the enactment of the act.

Senator GERRY. The income tax will not be paid, then, until 1937, the first payment comes in in 1937?

Mr. PARKER. That is correct.

The CHAIRMAN. Mr. Parker, let us go along as quick as we can here, so you can close.

Senator GERRY. Aren't we going to discuss the whole bill, Mr. Chairman, later with Mr. Parker?

The CHAIRMAN. Yes; and I have asked the Secretary of the Treasury to be in the first thing in the morning.

Senator GERRY. I mean Mr. Parker.

The CHAIRMAN. Yes; we will have Mr. Parker available to us all the time.

Senator GERRY. I mean so the public will get the benefit of what the bill means.

Senator COSTIGAN. What do you expect from title II, Mr. Parker?

Mr. PARKER. We expect on title II \$86,000,000, which is an inheritance tax, and \$24,000,000 under the gift tax of title III, making \$110,000,000 altogether for these two taxes.

Senator COSTIGAN. \$34,000,000 the first year?

Mr. PARKER. That is for a full year of operation. No; that will not be for the first year, Senator. That is a rather deceiving figure. The bill provides liberal extensions of time for the payment of the taxes, and it will be, I should say, 3 or 4 years before we would get up to a proper, even level on any receipts from this inheritance tax.

Senator GERRY. How much time do you allow, Mr. Parker, 10 years?

Mr. PARKER. Ten years. That is, it does not have to be allowed. The Commissioner has the authority to extend the time to 10 years if good reasons and hardship are shown.

Senator GERRY. How do you do that? What is the interest charge on the 10 years?

Mr. PARKER. Well, the return is due in the inheritance tax 18 months after the decedent's death, and there is no interest for that 18 months, and for the next 6 months. That is, the first 2 years of the inheritance tax is without interest. Then the bill provides for the next 3 years that there should be a 3-percent rate of interest, and then for the rest of the period of the extension it is 6 percent.

Senator GERRY. Now, Mr. Parker, as I understand the theory of this inheritance tax, the beneficiary does not receive the bequest until after the estate tax has been paid, because the first thing that has to be paid is the estate tax?

Mr. PARKER. That is correct.

Senator GERRY. Which is the tax on the whole net estate, not on the beneficial interest. Now, in that case the present law requires 2 years, does it not?

Mr. PARKER. No, sir.

Senator GERRY. What is the present law in regard to the estate tax?

Mr. PARKER. The present law in regard to the estate tax is that the return is due 1 year after death, and in the inheritance tax we give them 18 months.

Senator GERRY. In other words, in 1 year after death in the estate tax they have to pay interest?

Mr. PARKER. No, Senator.

Senator GERRY. How much time is given on that?

Mr. PARKER. We give 6 months' extension without interest on the estate tax, bringing it up to 18 months, and we give 6 months' extension in an inheritance tax without interest, bringing that up to 2 years. That is they allow a 6 months' lag for the inheritance tax behind the estate tax, for the very reason which you said.

Senator GERRY. Of course that is a very short period if the estate is a large estate, because it would be perfectly impossible to put the estate in a very liquid condition in a short time. What is the rate of interest in the estate tax?

Mr. PARKER. Six percent, Senator.

Senator GERRY. How long can that run?

Mr. PARKER. That would run 8 years.

The CHAIRMAN. That is the estate tax?

Mr. PARKER. Six percent all the way through.

The CHAIRMAN. How much on the inheritance tax?

Mr. PARKER. We get 3 and 6 on the inheritance, 3 percent for the first 3 years.

Senator GERRY. Let me see if I understand this clearly, then. Then you have a 6-percent rate of interest running on the estate, and then on top of that the beneficiary, and suppose it is only one beneficiary, must also pay 6 percent, so you have got 12-percent rate of interest after 2 years. Am I right on that?

Mr. PARKER. No; you would have 9 percent, Senator.

Senator GERRY. Why? It is only 3 in the first years.

Mr. PARKER. In the first 3 years.

Senator GERRY. Then how many years would it run?

Mr. PARKER. After 5 years you would pay the full amount.

Senator GERRY. Then you would pay 12 percent?

Mr. PARKER. Yes; if you want to add them together.

Senator GERRY. I mean you would have to do that in settling an estate, because naturally the executors of the estate would be doubtful, if there was going to be any appreciable tax, they would be doubtful whether they could allow the heirs any income until they wound up the estate.

Senator WALSH. That has all got to come out of the decedent's estate.

Senator GERRY. Of course the estate will not pay its tax, if it is a large estate, and the estate realizes it is liable to be over 100 percent.

Mr. PARKER. If the estate has anything liquid the Commissioner can receive part payment of the tax. They can cut the interest down. They do not have to pay the whole tax, they can pay in installments.

Senator GERRY. They cannot pay it if the estate is a large corporation which is owned by one individual; they have to wait until they sell it, if they can. Now, that is a possibility. What have you done in this bill in regard to the provision which we had in the old bill in regard to subsequent death? You remember in the 1917 act I think we allowed 5 years, did we not; that if an heir died within 5 years he would inherit the estate and there was no payment of the tax. In England, as I recollect it, in 1917, it was found where two or three beneficiaries died in succession, that there was a life estate and death ended the life estate, but when they die in succession in a short period of time the probably infant heir owed the Government money instead of receiving any estate. So we put a provision in the law, as I recollect, saying that the tax could not be collected more than once in 5 years. Isn't that right?

Mr. PARKER. We have a provision which exempts property in the hands of a second decedent which that second decedent received from the prior decedent in the 5 years. That is still in our estate-tax law.

Senator GERRY. Well, that ought to be increased, naturally.

Mr. PARKER. In the bill as introduced there is no provision for relieving the tax on a prior tax property, Senator.

Senator GERRY. There is no provision?

Mr. PARKER. Not in the inheritance tax.

Senator GERRY. Well, then, of course it would make it much more difficult to work out, if you wanted to borrow money on the estate, in order to try to work it out.

Mr. PARKER. Of course there are some arguments both ways. I think probably England has the best rule. They give a percentage reduction according to whether the second death occurs 1, 2, 3, 4, or 5 years after the first decedent.

Senator GERRY. But the English inheritance tax is 6 percent at the highest. This is 75 percent.

Mr. PARKER. I am talking of their estate tax. They derive their principal revenue from the estate tax.

Senator GERRY. The English estate tax is 50 percent and this is 60 percent.

Mr. PARKER. No; the rate in this bill goes to 75 percent.

Senator GERRY. On the inheritance tax, but in the estate tax the highest English rate is 50 percent and the present rate is 60 percent here. The highest rate on the English inheritance tax is 6 percent and in this bill it is 75 percent.

Mr. PARKER. The highest percent on the inheritance tax in England, on strangers, is 10 percent. On a widow it is only 1 percent, on collaterals 5 percent.

Senator GERRY. And on strangers 10 percent?

Mr. PARKER. Yes, sir.

Senator GERRY. That is the highest they go. So the highest tax that England collects on the estate and on the inheritance is 60 percent?

Mr. PARKER. That is correct.

Senator GERRY. While we collect 60 percent on the estate alone. On top of that 75 percent on the inheritance, under this bill.

Mr. PARKER. Yes, sir.

Senator GERRY. How do the States work into that? Of course there is also with us something which they haven't got in England, an inheritance and estate tax in many of the States. Have you got the figures on those?

Mr. PARKER. Yes; of course, they all vary. We have a couple of States that have inheritances taxes that go as high as 40 percent on strangers, but looking at the average picture, the State taxes generally are put high enough to take up the 80-percent credit clause of the Federal law, but there will be some exceptions to that. New Jersey has a high inheritance tax.

Senator WALSH. Can you prepare for us, Mr. Parker, a list of the States that have inheritance taxes, and what those taxes are, and also a table showing about how much would be the tax in the largest estates where the inheritance tax is large, adding together the Federal tax and the State tax?

Mr. PARKER. Yes; I can have it prepared for the record.

Senator WALSH. So we can see just what hole is made in the estate through the Federal and State tax, the inheritance tax.

(Mr. Parker subsequently submitted the following six tables in response to request for such data.)

TABLE 1.—Range of rates under State inheritance tax laws

State	Widow	Husband	Lineal issue	Ancestors	Brothers, sisters, and their issue	Other collaterals	All others
Alaska.....	1 - 3½	1½- 5¼	1 - 3½	1½- 5¼	3 -10½	4 -14	5 -17½
Arizona.....	1 - 5	1 - 5	1 - 5	1 - 5	2 -10	3 -15 4 -20	5 -25
Arkansas.....	1 -10	1 -10	1 -10	1 -10	2 -20	4 -40	4 -40
California.....	2 - 8	1 -10	1 -10	1 -10	3 -12	4 -12	5 -12
Colorado.....	2 - 7½	2 - 7½	2 - 7½	2 - 7½	3 -10	4 -14	7 -16
Connecticut.....	1 - 4	1 - 4	1 - 4	1 - 4	2 - 5	5 - 8	5 - 8
Delaware.....	1 - 4	1 - 4	1 - 4	1 - 4	2 - 5	2 - 5	5 - 8
Hawaii.....	1½- 3½	1½- 3½	1½- 3½	3 - 6½	3 - 6½	3 - 6½	3 - 6½
Idaho.....	1 -10	1 -10	1 -10	1 -10	2 -15	3 -20	5 -20
Illinois.....	2 -14	2 -14	2 -14	2 -14	2 -14	6 -16	10 -30
Indiana.....	1 -10	1 -10	1 -10	1 -10	5 -15	7 -20	7 -20
Iowa.....	1 - 8	1 - 8	1 - 8	1 - 8	5 -10	10 -15	10 -15
Kansas.....	½- 2½	1 - 5	1 - 5	1 - 5	3 -12½	5 -13	5 -15
Kentucky.....	1 -16	1 -16	1 -16	1 -16	2 -16	2 -16	6 -16
Louisiana.....	2 - 3	2 - 3	2 - 3	2 - 3	5 - 7	5 - 7	5 -10
Maine.....	1 - 3	1 - 3	1 - 3	1 - 3	4 - 6	4 - 6	5 - 8
Maryland.....	1 - 1	1 - 1	1 - 1	1 - 1	7½- 7½	7½- 7½	7½- 7½
Massachusetts.....	1 - 7	1 - 7	1 - 7	1 - 7	3 -12	3 -12	5 -12
Michigan.....	1 - 8	1 - 8	1 - 8	1 - 8	1 - 8	5 -15	5 -15
Minnesota.....	1 - 4	1½- 6	1 - 4	1½- 6	3 -12	4 -16	5 -20
Missouri.....	1 - 6	1 - 6	1 - 6	1 - 6	3 -18	4 -24	5 -30
Montana.....	2 - 8	2 - 8	2 - 8	2 - 8	4 -16	6 -24	8 -32
Nebraska.....	1 - 1	1 - 1	1 - 1	1 - 1	1 - 1	4 - 4	4 -12
New Hampshire.....	(1)	(1)	(1)	(1)	5 - 5	5 - 5	5 - 5
New Jersey.....	1 -16	1 -16	1 -16	1 -16	5 -16	8 -16	8 -16
New Mexico.....	1 - 1	1 - 1	1 - 1	1 - 1	5 - 5	5 - 5	5 - 5
New York.....	1 - 4	1 - 4	1 - 4	1 - 4	2 - 5	5 - 8	5 - 8
North Carolina.....	1 -10	1 -10	1 -10	1 -10	3 -23	3 -23	8 -25
Ohio.....	1 - 4	1 - 4	1 - 4	1 - 4	5 - 8	5 - 8	7 -10
Oklahoma.....	1 -16	1 -16	1 -16	1 -16	2 -16	6 -16	6 -16
Oregon.....	(1)	(1)	(1)	(1)	1 -15	1 -15	2 -25
Pennsylvania.....	2 - 2	2 - 2	2 - 2	2 - 2	10 -10	10 -10	10 -10
Rhode Island.....	½- 3	½- 3	½- 3	½- 3	½- 3	5 - 8	5 - 8
South Carolina.....	1 - 6	1 - 6	1 - 6	1 - 6	2 - 7	2 - 7	4 -14
South Dakota.....	1 - 4	2 - 8	1 - 4	2 - 8	3 -12	4 -16	5 -20
Tennessee.....	1 - 5	1 - 5	1 - 5	1 - 5	5 -10	5 -10	5 -10
Texas.....	1 - 6	1 - 6	1 - 6	1 - 6	3 -10	4 -15	3 -20
Vermont.....	1 - 5	1 - 5	1 - 5	1 - 5	5 - 5	5 - 5	5 - 5
Virginia.....	1 - 5	1 - 5	1 - 5	1 - 5	2 -10	5 -15	5 -15
Washington.....	1 - 5	1 - 5	1 - 5	1 - 5	3 -12	3 -12	10 -25
West Virginia.....	3 -13	3 -13	3 -13	3 -13	4 -18	7 -25	10 -30
Wisconsin.....	2 -10	2 -10	2 -10	2 -10	4 -20	6 -30	8 -40
Wyoming.....	2 - 2	2 - 2	2 - 2	2 - 2	2 - 2	4 - 4	6 - 6
Average range of rates.....	1.2- 6.4	1.3- 6.7	1.2- 6.5	1.3- 6.8	3.3-11.2	5 -13.7	6 -16.5

¹ Exempt.² Law became inoperative Sept. 1, 1930.³ Law became inoperative Apr. 23, 1935.

TABLE 2.—*Specific exemptions under State inheritance tax laws*

	Widow	Husband	Lineal issue	Ancestors lineal	Brothers, sisters and their issue	Other collaterals	All others
Alaska.....	\$10,000	\$10,000	\$10,000	\$3,000	\$1,000	\$250	\$100
Arizona.....	10,000	2,000	2,000	2,000	500	250-150	100
Arkansas.....	6,000	2,000	¹ 2,000	2,000	2,000	None	None
California.....	25,000	10,000	² 10,000	10,000	5,000	1,000	500
Colorado.....	20,000	10,000	10,000	10,000	2,000	None	None
Connecticut.....	10,000	10,000	10,000	10,000	3,000	500	500
Delaware.....	20,000	20,000	3,000	3,000	1,000	1,000	None
Hawaii.....	5,000	5,000	5,000	500	500	500	500
Idaho.....	10,000	4,000	³ 4,000	4,000	2,000	1,000	500
Illinois.....	20,000	20,000	20,000	20,000	10,000	500	100
Indiana.....	15,000	2,000	⁴ 2,000	2,000	500	100	100
Iowa.....	40,000	40,000	15,000	10,000	None	None	None
Kansas.....	75,000	15,000	15,000	15,000	5,000	None	None
Kentucky.....	20,000	5,000	⁵ 5,000	5,000	2,000	500	500
Louisiana.....	5,000	5,000	5,000	5,000	1,000	1,000	500
Maine.....	10,000	10,000	10,000	500	500	500	500
Maryland ⁶	500	500	500	500	500	500	500
Massachusetts.....	10,000	10,000	10,000	10,000	1,000	1,000	1,000
Michigan.....	30,000	30,000	5,000	5,000	5,000	None	None
Minnesota.....	10,000	10,000	10,000	3,000	1,000	250	100
Missouri.....	20,000	20,000	5,000	5,000	500	250	100
Montana.....	17,500	5,000	2,000	2,000	500	None	None
Nebraska.....	10,000	10,000	10,000	10,000	10,000	2,000	None
New Hampshire.....	(?)	(?)	(?)	(?)	None	None	None
New Jersey.....	5,000	5,000	5,000	5,000	None	None	None
New Mexico.....	10,000	10,000	10,000	10,000	10,000	500	500
New York ⁸	5,000	5,000	5,000	5,000	None	None	None
North Carolina.....	10,000	2,000	5,000	2,000	None	None	None
Ohio.....	5,000	3,500	5,000	3,500	500	None	None
Oklahoma ⁹	15,000	5,000	10,000	5,000	1,000	500	500
Oregon.....	(?)	(?)	(?)	(?)	1,000	1,000	¹⁰ 500
Pennsylvania.....	None	None	None	None	None	None	None
Rhode Island.....	25,000	25,000	25,000	25,000	25,000	1,000	1,000
South Carolina.....	10,000	10,000	7,500	5,000	500	500	200
South Dakota.....	10,000	10,000	10,000	3,000	500	200	100
Tennessee.....	10,000	10,000	10,000	10,000	1,000	1,000	1,000
Texas.....	25,000	25,000	25,000	25,000	10,000	1,000	500
Vermont.....	10,000	10,000	10,000	10,000	None	None	None
Virginia ¹¹	10,000	10,000	10,000	10,000	4,000	1,000	1,000
Washington.....	10,000	10,000	5,000	10,000	5,000	None	None
West Virginia.....	15,000	5,000	5,000	5,000	None	None	None
Wisconsin.....	15,000	2,000	2,000	2,000	500	250	100
Wyoming.....	10,000	10,000	10,000	10,000	10,000	5,000	None
Average exemption.....	14,600	10,075	8,800	6,900	2,840	563	250

¹ Minor child, \$4,000.² Minor child, \$24,000.³ Minor, child, \$10,000.⁴ Minor child, \$5,000.⁵ Minor child, \$10,000.⁶ If the beneficiary's share exceeds \$500, no exemption.⁷ Exempt.⁸ Became inoperative Sept. 1, 1930.⁹ Inoperative after Apr. 22, 1935.¹⁰ If over \$500, no exemption.¹¹ Effective up to June 19, 1934 and after Dec. 31, 1936. In the intervening period \$5,000 for widow, husband, issue, and ancestors, and \$2,000 for brothers, sisters, and their issue.

TABLE 3.—*Revenue from death taxes, Federal and local*

	Federal (1934)	Local (1932)	Total	Per capita burden		
				Federal	Local	Total
Alabama.....	\$238,000	-----	\$238,000	\$0.09	-----	\$0.09
Arizona.....	46,000	\$80,000	126,000	.10	\$0.18	.28
Arkansas.....	57,000	95,000	152,000	.03	.05	.08
California.....	5,920,000	10,094,000	16,014,000	.97	1.67	2.64
Colorado.....	1,776,000	777,000	2,553,000	1.69	.74	2.43
Connecticut.....	2,135,000	4,097,000	6,232,000	1.30	2.49	3.79
Delaware.....	420,000	2,067,000	2,487,000	1.74	8.58	10.32
Florida.....	2,222,000	170,000	2,392,000	1.43	.11	1.54
Georgia.....	394,000	278,000	672,000	.13	.10	.23
Idaho.....	31,000	41,000	72,000	.67	.09	.16
Illinois.....	6,575,000	6,534,000	13,109,000	.84	.83	1.67
Indiana.....	729,000	1,914,000	2,673,000	.22	.59	.81
Iowa.....	311,000	868,000	1,119,000	.13	.32	.45
Kansas.....	433,000	463,000	896,000	.23	.24	.47
Kentucky.....	423,000	677,000	1,100,000	.16	.26	.42
Louisiana.....	498,000	528,000	1,026,000	.23	.25	.48
Maine.....	1,239,000	921,000	2,160,000	1.54	1.15	2.69
Maryland.....	2,045,000	2,162,000	4,207,000	1.23	1.30	2.53
Massachusetts.....	8,319,000	11,688,000	20,007,000	1.93	2.71	4.64
Michigan.....	3,099,000	5,580,000	8,679,000	.61	1.11	1.72
Minnesota.....	951,000	1,828,000	2,779,000	.37	.70	1.07
Mississippi.....	125,000	30,000	155,000	.06	.01	.07
Missouri.....	1,521,000	2,753,000	4,274,000	.41	.75	1.16
Montana.....	43,000	417,000	460,000	.08	.78	.86
Nebraska.....	310,000	180,000	490,000	.22	.13	.35
Nevada.....	19,000	-----	19,000	.20	-----	.20
New Hampshire.....	754,000	380,000	1,134,000	1.61	.81	2.42
New Jersey.....	6,055,000	11,180,000	17,163,000	1.44	2.65	4.09
New Mexico.....	25,000	24,000	49,000	.06	.05	.11
New York.....	33,934,000	45,802,000	79,736,000	2.62	3.53	6.15
North Carolina.....	208,000	428,000	636,000	.06	.13	.19
North Dakota.....	19,000	29,000	48,000	.03	.04	.07
Ohio.....	3,820,000	7,699,000	11,519,000	.56	1.13	1.69
Oklahoma.....	135,000	227,000	362,000	.05	.09	.14
Oregon.....	438,000	823,000	1,261,000	.45	.84	1.29
Pennsylvania.....	10,892,000	18,933,000	29,825,000	1.11	1.93	3.04
Rhode Island.....	2,014,000	1,120,000	3,134,000	2.86	1.60	4.46
South Carolina.....	96,000	132,000	228,000	.05	.08	.13
South Dakota.....	31,000	241,000	272,000	.04	.34	.38
Tennessee.....	253,000	771,000	1,024,000	.09	.29	.38
Texas.....	1,359,000	910,000	2,269,000	.23	.15	.38
Utah.....	16,000	166,000	182,000	.03	.32	.35
Vermont.....	89,000	432,000	521,000	.25	1.20	1.45
Virginia.....	689,000	518,000	1,207,000	.28	.21	.49
Washington.....	242,000	911,000	1,153,000	.15	.57	.72
West Virginia.....	280,000	418,000	698,000	.16	.24	.40
Wisconsin.....	783,000	4,066,000	4,849,000	.26	1.36	1.62
Wyoming.....	19,000	66,000	85,000	.08	.29	.37
Total.....	1 102,030,000	149,416,000	251,446,000	.81	1.19	2.00

¹ Does not include \$1,995,000 collections in the District of Columbia and Hawaii.

TABLE 4.—*Gift tax rates and exemption in the States*

OREGON

[Specific exemption of \$10,000]

Net gifts (after exemption):	Percent, rates
\$0 to \$10,000.....	4
\$10,000 to \$30,000.....	9
\$30,000 to \$50,000.....	12
\$50,000 to \$100,000.....	17
\$100,000 to \$300,000.....	18
\$300,000 to \$500,000.....	20
\$500,000 to \$1,000,000.....	22
Over \$1,000,000.....	25

TABLE 4.—*Gift tax rates and exemptions in the States—Continued*

VIRGINIA

Net gifts	Class A	Class B	Class C
	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>
\$1,000 to \$2,000.....	0	0	5
\$2,000 to \$5,000.....	0	2	5
\$5,000 to \$25,000.....	1	2	5
\$25,000 to \$50,000.....	1	4	7
\$50,000 to \$100,000.....	2	6	9
\$100,000 to \$500,000.....	3	8	12
\$500,000 to \$1,000,000.....	4	10	15
Over \$1,000,000.....	5	10	15

Note: Class A, ancestor, spouse, issue; class B, brother, sister, nephews, or nieces; class C, all others.

WISCONSIN

	Class A	Class B	Class C	Class D
	¹ \$2,000	\$500	\$250	\$100
Exemption.....				
Net gifts (after exemption):				
First \$25,000.....	2	4	6	8
\$25,000 to \$50,000.....	4	8	12	16
\$50,000 to \$100,000.....	6	12	18	24
\$100,000 to \$500,000.....	8	16	24	32
\$Over \$500,000.....	10	20	30	40

¹ Widow, \$15,000.

NOTE.—Class A, husband, wife, issue, ancestor; Class B, brother, sister, or their issue, son or daughter-in-law; Class C, aunt or uncle or issue; Class D, all others.

TABLE 5.—*Status of State personal income tax laws June 1, 1935*

State	Exemptions		Range of rates	Upper limit of graduation
	Single	Married		
			<i>Percent</i>	
Alabama.....	\$1,500	\$3,000	1 -5	\$8,000
Arizona.....	800	1,600	1 -4½	10,000
Arkansas.....	1,500	2,500	1 -5	25,000
California.....	1,000	2,500	1 -15	250,000
Delaware.....	1,000	2,000	1 -3	10,000
Georgia.....	1,500	3,500	1 -5	20,000
Idaho.....	700	1,500	1½-8	5,000
Iowa.....	600	1,200	1 -5	5,000
Kansas.....	750	1,500	1 -4	7,000
Louisiana.....	1,000	2,500	2 -6	50,000
Minnesota.....	1,200	2,000	1 -5	10,000
Mississippi.....	750	1,500	2½-6	15,000
Missouri.....	1,000	2,000	1 -4	9,000
Montana.....	1,000	2,000	1 -4	6,000
New Mexico.....	1,500	2,500	1 -4	100,000
New York.....	1,000	2,500	2 -7	9,000
North Carolina.....	1,000	2,000	3 -6	6,000
North Dakota.....	500	1,500	1 -15	15,000
Oklahoma.....	1,000	2,000	1- 6	14,000
Oregon.....	800	1,500	2 -7	5,000
Pennsylvania.....	1,000	2,500	2 -8	100,000
South Carolina.....	1,000	1,800	2 -5	6,000
South Dakota.....	600	1,200	1 -8	318,000
Utah.....	1,000	2,000	1 -4	8,000
Virginia.....	1,000	2,000	1½-3	5,000
Washington.....	1,000	2,500	3 -7	4,000
Wisconsin.....	800	1,600	1 -7	12,000

NOTE.—In addition, the following States tax all income, or certain types of income, at flat rates: Massachusetts, New Hampshire, Ohio, Tennessee, and Vermont.

TABLE 6.—*Comparison of income tax under present law and revenue bill of 1935 as introduced in House of Representatives with income-tax burden in Great Britain*

* [Married man, no dependents, all earned income]

Net income	Tax revenue bill H. R. 8974	Percent of tax to net income	Tax present law (1934)	Percent of tax to net income	Tax Great Britain ¹	Percent of tax to net income
\$1,000.....	0	0	0	0	0	0
\$1,500.....	0	0	0	0	\$26.25	1.75
\$3,000.....	\$8	.26	\$8	.26	247.50	8.25
\$5,000.....	80	1.60	80	1.60	607.50	12.14
\$10,000.....	415	4.15	415	4.15	1,620.00	16.20
\$20,000.....	1,589	7.94	1,589	7.94	4,729.38	23.64
\$50,000.....	8,869	17.73	8,869	17.73	18,216.88	36.43
\$100,000.....	32,469	32.46	30,594	30.59	45,279.38	45.27
\$150,000.....	63,394	42.26	58,544	39.02	74,404.38	49.60
\$200,000.....	95,344	47.67	87,019	43.50	104,904.38	52.45
\$300,000.....	162,244	54.08	144,994	48.31	167,279.38	55.75
\$500,000.....	304,144	60.82	263,944	52.78	294,779.38	58.95
\$1,000,000.....	679,044	67.90	571,394	57.13	613,529.38	61.35
\$2,000,000.....	1,449,019	72.45	1,201,369	60.06	1,251,029.38	62.55
\$5,000,000.....	3,788,994	75.77	3,091,369	61.82	3,163,529.38	63.27
\$10,000,000.....	7,738,969	77.38	6,241,369	62.41	6,351,029.38	63.51
\$20,000,000.....	15,638,969	78.19	12,541,369	62.70	12,726,029.38	63.63

¹ Conversion unit, £1 equals \$5.

The CHAIRMAN. You can get that up. We have got to recess now. We will have an executive session.

(Whereupon, at the hour of 12 noon, the committee adjourned until 10 a. m. of the following day, Wednesday, July 31, 1935.)

REVENUE ACT OF 1935

WEDNESDAY, JULY 31, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to call, at 10 a. m., in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

Present: Senators Harrison (chairman), King, George, Walsh, Barkley, Connally, Costigan, Clark, Byrd, Gerry, Hastings, and Capper.

The CHAIRMAN. I may state for the information of the committee that the Secretary of the Treasury has requested that he come in the morning instead of this morning, so he will not be before the committee this morning.

STATEMENT OF NOEL SARGENT, OF NEW YORK, N. Y., NATIONAL ASSOCIATION OF MANUFACTURERS

The CHAIRMAN. Mr. Sargent, you represent the National Association of Manufacturers?

Mr. SARGENT. That is right, and several other organizations also, Mr. Chairman. With other witnesses, we represent a number of other organizations throughout the country by specific request.

The CHAIRMAN. You may proceed, Mr. Sargent.

Mr. SARGENT. My name is Noel Sargent. I am secretary and economist of the National Association of Manufacturers.

In conjunction with other representatives of our association who will subsequently appear before this committee—H. B. Spalding, vice chairman A. G. Spalding & Bros.; vice chairman of National Association of Manufacturers tax committee; H. W. Prentis, Jr., president Armstrong Cork Co.—I represent also by specific request the following organizations:

California Manufacturers Association.

Wilmington, Del., Employers Association.

Manufacturers Association of Wilmington, Del.

Iowa Manufacturers Association.

Associated Industries of Kentucky.

Louisiana Manufacturers Association.

Michigan Manufacturers Association.

Minnesota Employees Association.

We appear before this Committee with three underlying premises as the basis of our discussion. The first of these is that practically all citizens strongly desire a balanced Budget, realizing that sound

national credit cannot long endure unless Government receipts equal Government expenditures. There is, however, a wide conflict of opinion as to whether such Budget balancing should be accomplished by governmental economy, by increased taxes, or by a combination of both economy and increased taxation.

Our second premise is that taxes levied by the Federal Government should be sound in principle both of themselves and as part of a national tax system.

Our third premise is that the rates of any tax levied should not be so oppressive as to cause or continue industrial decline. We commend to your attention in this connection the following statement made to Congress in 1919 by President Wilson:

There is a point at which in peace times high rates of income and profits taxes discourage energy, remove the incentive to new enterprise, encourage extravagant expenditures, and produce industrial stagnation with consequent unemployment and other attendant evils.

We further direct your attention to the following statement made March 19 by Governor Eccles, of the Federal Reserve Board:

A substantial increase in taxes at the present time, if they would pull into the Treasury money which would otherwise be spent and thus reduce private spending, would be of no particular help. (Hearings before House Banking and Currency Committee, p. 403.)

We venture to go further and say with President Wilson that "a substantial increase in taxes" at this time might actually "discourage energy, remove the incentive to new enterprises" and thus create unemployment at the very time every step should be taken for its reduction.

ANALYSIS OF TAX PRINCIPLES

It is my purpose to present observations concerning fundamental economic principles involved in certain of the tax proposals now pending and under consideration by this committee which directly affect business enterprises. Other aspects of these pending proposals will be discussed before this committee by other representatives of the National Association of Manufacturers.

GRADUATED CORPORATION INCOME TAX

The principle involved in the graduated corporation income tax was presented as follows to the Congress:

We have established the principle of graduated taxation in respect to personal incomes, gifts, and estates. We should apply the same principle to corporations. Today the smallest corporation pays the same rate on its net profits as the corporation which is one thousand times its size. I therefore recommend the substitution of a corporation income tax according to the size of corporation income in place of the present uniform corporation income tax. (Presidential message.)

The analogy currently made is most plausible. The basis of its plausibility and appeal is that those individuals who are more able to pay taxes should and do pay not only more taxes but at a higher rate than those less able to pay; that the corporation with the larger income should also not only actually pay more but should pay at a higher rate. It will thus be seen that the two tax principles alleged to support the proposal for a graduated corporation income tax are that it conforms first to the "ability to pay" principle, and that is

conforms secondly to the "graduated" or "progressive" rate theory of income taxation.

ABILITY TO PAY PRINCIPLE VIOLATED

When levied upon corporations a graduated corporation income tax violates the principle that taxes should be related to the ability to pay. Prof. Harley L. Lutz, of Princeton University, former president of the National Tax Association, pointedly says:

I consider a graduated tax on corporations or other business net income as utterly unsound and unscientific; the proposition is based on total misunderstanding of the principle of ability in taxation. (Telegram of June 29.)

Other outstanding economists who also declare that a graduated corporation income tax violates the ability to pay principle include Dr. H. A. Millis, of the University of Chicago, formerly president of the American Economic Association:

Unless the objective is to discourage big business on a corporate basis—

And as we have seen an effort to do this would, instead of being only a penalty or burden upon a few, be a direct burden upon millions of stockholders spread throughout the entire United States—

the tax rates should vary with the ability of investors and not the size of corporate investment. The small income of a very small corporation may mean a large profit upon investment and the large income of a very large corporation may mean inadequate profit. (Telegram of June 27.)

Alfred E. Holcomb, former president of the National Tax Association:

A graduated tax on business profits based on mere amount is entirely without justification. (Telegram of June 28.)

Henry F. Long, Commissioner of Corporations and Taxation for the State of Massachusetts and now president of the National Tax Association:

A corporation while an entity is not comparable to an individual. The large and successful corporation is generally found to have many shareholders with small average holdings, or the small investor is represented in stock held by institutions of savings or insurance companies whose funds for investment come from the small deposits and premium payments of many thrifty persons. If a graduated corporation income tax was operated it would most injure the small investor as becomes manifest when one considers the holdings of a savings institution, whose return from the investment makes a large or small payment on the capital deposited for saving by the individual depositor in proportion to the amount left after taxes for distribution. (Telegram of June 29.)

From these statements and subsequent evidence it is apparent that the overwhelming body of expert economic opinion is opposed to a graduated corporation income tax. I know of only two recognized experts who favor such a tax, one of these wholly endorsing it as a Federal matter, and the other favoring the principle, but desiring the tax to be very moderate and levied exclusively by the States (George Vaughan, of Little Rock, Ark., and William Bailey of Nephi, Utah, respectively, both former presidents of the National Tax Association). (Telegrams of July 2 and June 29.)

The experts who state that the graduated corporation income tax not only does not conform to the "ability to pay" principle but actually violates it, base their judgment upon the fact that the corporation is simply an aggregation of individuals, and that the income

of the corporation is in reality the income of these individuals. A graduated corporation income tax, therefore, bears no relation to the ability to pay of the individual stockholders. It has no relation, moreover, to the rate of profits earned on the total investment in the corporation, or the investment of any single individual in the corporation. Thus a large corporation earning 1 percent on its capital and the investor in its stocks may actually be taxed under any graduated corporation income-tax-rate schedule at a higher rate than the 10-percent profit earned by investors in a corporation having a smaller total investment.

A graduated corporation income tax, in short, may actually result in imposing the highest rate of taxation upon the small percentage of profit earned by a large corporation and a low rate of tax upon the large rate of profit earned by a small corporation.

A simple illustration reveals how the graduated corporation income tax violates the "ability to pay" principle. Henry Robinson invests \$1,000 in a \$500,000,000 corporation, which earns a 5-percent profit or a total of \$25,000,000. Considering now the first proposed table of corporation income taxes presented by Secretary Morgenthau July 8 to the House Ways and Means Committee, table 21; similar examples could, of course, be presented on the basis of the other two rate schedules we find that the \$50 earned upon Robinson's \$1,000 investment would be taxed $17\frac{1}{2}$ percent or \$8.75 before Robinson would be entitled to receive any dividend.

Fred Adams, his neighbor, with the same annual income, invests \$1,000 in a \$100,000 corporation which also earns 5 percent on its capital investment, but because the total corporation profit in this case is much smaller the \$50 earned on Adams' \$1,000 investment will be taxed only 12 percent or \$6 before he is entitled to receive a dividend.

Even under the rate schedule just proposed by the House Ways and Means Committee the same unsound principle prevails, even though the spread of the rate is much narrower. In this instance the investment of the man in the large corporation would be taxed $14\frac{1}{4}$ percent or \$7.13, while the income of the investor in the small corporation earning the same amount of its capital stock would be taxed $13\frac{1}{4}$ percent or \$6.63 before he is entitled to receive his dividend.

Here are two men with equal income, equal investments and equal earnings on their investments, yet under this proposal the man will be penalized who has invested in the large company—there are millions of such investors in the United States.

TAX MAY BE REGRESSIVE INSTEAD OF PROGRESSIVE

Not only would a graduated corporation income tax violate the "ability to pay" principle, but it also violates the principle that income taxes should be levied at progressively higher rates upon those with greater ability to pay. In fact, instead of apparently progressive rates a graduated corporation income tax may actually impose regressive rates, bringing about increased taxation of those with less ability to pay.

This has been soundly stated as follows by Prof. E. R. A. Seligman, one of the outstanding tax authorities of the United States, former president of both the American Economic Association and the National Tax Association. Dr. Seligman says on this point:

A progressive corporation tax then does not necessarily mean a progressive tax on the individual shareholders, and still less does it imply a progressive tax on the individual bondholders. It may denote just the reverse. The application of the progressive principle to corporations is therefore of dubious expediency. (American Economic Association publications vol. 9, 1908, third series.)

The principle involved has been similarly stated by Prof. Hudson B. Hastings of the economics department of Yale University:

The proposed Federal corporation income tax would constitute a regressive discriminatory tax upon common-stock holders. Like the present corporation income tax it discriminates against the small investor in common stocks, but in addition it discriminates against the small investor in large corporations as compared with both large and small investors in small corporations. (Telegram of June 26.)

Prof. C. C. Plehn, of the University of California, former president of the American Economic Association, and known as one of the leading tax experts of the United States, declares in this connection:

A graduated Federal tax upon corporations will * * * be especially burdensome upon widows and retired persons living on invested savings. Since it is the rate of profits, not mere absolute size that signifies, the basis of graduation is absurd. (Telegram of June 26.)

Here again let us consider an example which illustrates the manner in which the graduated corporation income tax may result in a situation under which those with less ability to pay will be taxed more. Thus John Little Jones with an income of \$5,000 a year invests \$1,000 in a \$500,000,000 corporation earning 5 percent. The \$50 earned by Jones on his \$1,000 investment would be taxed 17½ percent (under table 21 presented by Secretary Morgenthau) before he would be entitled to receive a dividend. Henry Magnus Brown, his wealthy neighbor, with a \$50,000 yearly income invests \$10,000 in a \$100,000 company which also earns 5 percent on the total investment. Yet the \$500 earned upon Brown's \$10,000 investment would be taxed only 12 percent before he is entitled to receive a dividend. This means that the profit earned upon the income of the smaller investor is to be taxed at a higher rate than the profit earned upon the investment of the large investor. While the spread will be smaller the same discriminatory principle operating against the man with less ability to pay prevails in the bill presented by the House committee.

Can there be any further doubt that this tax is discriminatory, that it violates the principle of ability to pay, and that in many cases it would be regressive instead of progressive? In the illustration last cited, the man with the far larger income would have a smaller tax levied upon the profits from his investment than the tax levied on the profits earned by the small investor with the small income.

STOCKHOLDERS MUST BEAR TAX

It is important in connection with any tax to consider its incidence—that is, by whom must the tax be ultimately paid. Tax experts have long recognized that some taxes can be shifted to those who pay in the first instance to others. While some taxes may be shifted in part, other taxes cannot be shifted at all. This question is raised in connection with income taxes upon corporations. It is obvious that if an income or profits tax upon corporations can be shifted it would not result in a detrimental effect upon stockholders, but would be, in effect, a national sales tax. Leading tax authorities

maintain that taxes upon profits cannot be shifted, but that they are borne by the corporations themselves, which means that they are borne by the stockholders of these corporations.

Upon this subject of tax incidence there is perhaps no greater authority in the United States than E. R. A. Seligman of Columbia University, and I specifically direct your attention to the following statements made by Professor Seligman:

The belief so widely prevalent among business men that income taxes are added to the prices thus turns out to be fallacious, at least so far as surtaxes are concerned." (Academy of Political Science proceedings, vol. XI, May 1924, no. 1.)

But it can now be shown that the same is true of normal taxes. Despite the widely held belief to the contrary even a proportional income tax cannot be shifted (Ibid.). Tax on income is a tax on net profits, and net profits are not cost but the surplus over cost. Business profits are a result of business operations; they are a consequence of prices, not a cause of prices. A tax on business profits is not a part of cost as is a tax on business products. The latter can be shifted; the former cannot be shifted (Ibid.).

Following analysis of the same subject Prof. Harley F. Lutz, former president of the National Tax Association, declared (Public Finance, p. 338-339):

A general tax on corporate or business net incomes is not readily shifted. There is nothing inherent in the fact that a tax has been imposed on net income to give a business firm operating under competitive conditions any power over the price of its product than it did not otherwise possess. The mere imposition of a tax will not permit an automatic advance of price, unless its effect on marginal conditions of production is such as to cause a reduction in the supply of goods produced.

Since the corporate enterprise cannot shift its tax on net income by advancing prices, the burden must eventually be distributed between the laborers and the stockholders. Comparative bargaining strength may determine the extent to which the former group can be forced to assume a share. If the tax is passed back to the stockholders by reducing dividends, the effect may be ultimately a loss of capital and credit standing culminating in failure. The elimination of the extra-marginal firm tends to ease up the pressure on the supply of the commodity, to facilitate price advances, and to save the day, temporarily at least, for the other concerns. In this way shifting may be brought about, but there is here, quite obviously, a chain of events over which the individual concern has no control.

The National Industrial Conference Board has published a study of the effect of the Federal income tax on manufacturing and mercantile corporations which confirms the conclusion that economists had reached long before. An elaborate statistical investigation was made of the experience of several thousand business corporations during the period 1918 to 1925, on the basis of data supplied by these concerns, and the result of this detailed analysis may be expressed in a single sentence. The Federal tax on corporation incomes, in the fields of manufacturing and trade, is not shifted except in rare circumstances.

It will thus be seen that according to leading tax authorities the burden of a graduated corporation income tax or excess profits tax must be borne by the stockholders, and can not be shifted to consumers. In other words, the imposition of a graduated corporation income tax or excess profits tax has a direct and fairly immediate effect upon millions of stockholders.

The graduated corporation income tax, regardless of the rates which may be imposed, should be not placed upon our statute books. We submit that a tax which is unsound in principle should be energetically rejected regardless of whether the actual rates are high or low, or whether the spread of rates is large or small.

This committee and the Congress now have under consideration the application of an unjust principle; it is a principle which is not to be imposed merely upon a few corporations, but one which will detrimentally affect millions of stockholders throughout the entire United States. As a very practical proposition we direct your attention to the fact that L. H. Parker of the Joint Tax Committee, who testified before you yesterday, declared in December 1932:

No satisfactory system of applying the graduated rate principle to the net income of corporations has, as yet, been devised. (Report on Double Taxation printed for the use of the House Ways and Means Committee, 72d Cong., 2d sess., p. 240.)

We further direct your attention to the following striking statement made in 1918 by the distinguished Secretary of the Treasury, Hon. William Gibbs McAdoo, now Senator from California (1918 House Ways and Means Committee tax hearings, p. 15):

Any graduated tax upon corporations is indefensible in theory, for corporations are only aggregations of individuals, and by such a tax the numerous small stockholders of a great corporation may be taxed at a higher rate than the very wealthy large stockholders of a relatively small corporation.

We appeal to the committee to emphatically reject the idea of imposing upon millions of stockholders in the corporations of this country a tax which, in the words of the distinguished Secretary, is "indefensible."

EXCESS PROFITS TAX

H. R. 8974 contains in section 702 provision for an excess-profits tax in varying rates above profits exceeding 8 percent of adjusted declared value of capital stock as provided in section 701 of the Revenue Act of 1934. The specific effect of the proposed tax rates upon excess profits and the merits of the base proposed to be used for such a tax will be subsequently reviewed by other representatives of the National Association of Manufacturers.

In December 1932 Mr. L. H. Parker who testified before this committee yesterday, stated that the excess-profits tax "remedied" what he termed a defect in the corporation income tax—namely, that "it is not based on the ability to pay principle" since "there are no graduated rates." Mr. Parker then concluded because "this defect" is remedied in the excess-profits tax that "on a theoretical basis it is generally approved" (Report on Double Taxation presented to subcommittee of House Ways and Means Committee, December 1932, p. 84.)

I believe that Mr. Parker's statement fairly summarizes the theory held to justify an excess-profits tax. Without discussing the relative merits of the different bases for determining profits, we may note that under section 701 of the Revenue Act of 1934 and section 702 of H. R. 8974 the tax is related to "adjusted declared value" of capital stock, whereas the excess-profits tax of 1918 repealed by the act of 1921 levied a tax determined by the ratio between profits and invested capital. You may recall that invested capital as defined in 1918 act had little relation to the current value of the property employed in producing the income.

As previously stated the nature of the base proposed for an excess-profits tax will be reviewed by other representatives of our association. However, it may be observed from an economic standpoint

that the defects involved in applying any base and tax rate in the field of excess profits tax include the following:

DIFFICULTIES OF APPLICATION

(1) Does the method used for the determination of the base upon which the profits are estimated favor the concern with a liberal capitalization policy or the concern with a conservative capitalization policy? The excess-profits tax repealed by the act of 1921 put a premium on overcapitalization and a penalty upon conservative business practice. We do not believe that Congress will now desire to encourage any such procedure.

(2) What is a normal rate of profit? This bill declares that 8 percent is a normal profit for industry. Is the firm just entering the business world to be told that its normal rate of profit is the same as that of well-established and stable firms? A tax which discourages new ventures and confirms old ventures in their monopolies is economically unsound. Since all industries normally grow from small beginnings, they need encouragement and resources in the form of profits for future development, but an excess-profits tax deprives industry of these encouragements and resources, thus repressing development and checking enterprise in its very beginning.

Is the normal rate for an industry operating under exclusive patents legitimately the same as that of an industry in a more strictly competitive field? Is there to be any recognition of the fact that legitimate return on investment should be related to the relative risks undertaken by investors in different companies? What is the effect of an excess-profits tax, such as here proposed, upon industries with variable profits? Thus, the mining industry, for example, which may have long periods of losses followed by short periods of high profits. Or consider the steel industry of the United States—the great prince or pauper industry of the country. If allowances are not made in such industries for losses of previous years in levying taxes during years of profits then grave injustice is done the investors in such industries.

Can any tax law properly make allowance for factors such as these? If not, then the application of an excess-profits tax almost inevitably becomes inequitable. We may well recall in this connection the following statement made in 1917 by two former presidents of the National Tax Association—Professors Seligman and Haig, of Columbia University:

Especially in a comparatively new country like the United States, where risks are great and losses frequent, a profit of more than 8 percent is often necessary to justify investment * * *. At a period like the present, it is of the first importance not to put a check upon business enterprise or to cripple the desire of individuals to do their utmost in the way of productive capacity. (How to Finance the War, in the Columbia War Papers.)

(3) To offset in part at least some of the very practical difficulties just mentioned, it would seem that if an excess-profits tax is to be adopted the tax rate should be proportionate—that is, a single rate instead of progressive rates should be applied to all incomes above the so-called “normal” percentage prescribed by law. Progressive rates tend to reduce all profits to one level with relation to the base used. They thus penalize, as previously indicated, industries with widely variable profits in different years, and also tend to prevent the flow of capital into new enterprises where large profits are essential to induce capital to take the risks involved.

(4) We wish to suggest that if an excess-profits tax is to be considered, serious consideration should be given to the possibility of in some way relating the amount to be taxed to the average of profits over a preceding period of years. This would tend to remove the inequity involved in hitting a substantial profit whenever it showed its head, regardless of a substantial period of previous losses which may exist; as a precedent we may cite the fact that every belligerent nation levying an excess-profits tax during the war established a standard with reference to the normal income of the industry during a fixed period preceding the war. We therefore urge upon this committee that if an excess-profits tax shall be deemed essential, it should be predicated upon a comparison of a selected normal period which would give due consideration to the risk of the enterprise and the customary rate upon the investment under such conditions.

(5) In connection with the foregoing it may be pointed out that the British excess-profits tax in existence during the war provided that the statutory percentage of deduction (that is, the amount at which or beyond which the excess profits tax started) might upon application be increased with respect to any class of trade or business. The Board of Reference under this provision of the law had by 1917 allowed deductions of as high as 22½ percent in the case of certain extremely hazardous businesses.

(6) The proposal for an excess-profits tax is apparently predicated upon a belief that the higher rate of profits are found in the large industries. As a matter of fact available evidence from several sources indicates that there is remarkably little variation in the rate of profits earned by so-called "big business" and so-called "little business." An excess-profits tax therefore will bear with as much hardship on the small and moderate size concerns as on the large concerns of the United States.

(7) Summarizing these inequities in any excess profits tax and the difficulties involved in applying the sound tax principles to any excess profits tax, we might point out that the distinguished Secretary of the Treasury, Wm. G. McAdoo, now United States Senator from California, declared in 1918:

The theory of an excess profits tax is to tax profits over and above a given rate on capital * * *. The excess profits tax must rest upon the wholly indefensible notion that it is a function of taxation to bring all profits down to one level with relation to the amount of capital invested, and to deprive industry, foresight and sagacity of their fruits. (1918 House Ways and Means Committee hearings, p. 15.)

Senator CONNALLY. Right there may I ask you a question? You do not mean that; do you?

Mr. SARGENT. I am quoting the Secretary.

Senator CONNALLY. You are quoting it with approval. Do you mean to say that?

Mr. SARGENT. Yes, sir.

Senator CONNALLY. You mean to say the theory of an excess-profits tax is to level them all down to one level with relation to the amount of capital invested?

Mr. SARGENT. The tendency is to do so.

Senator CONNALLY. You only take a small percentage of the excess.

Mr. SARGENT. We know during the war it reached a very high percentage, Senator.

Senator CONNALLY. Sure, and it is a high percentage now, for that matter. You say the purpose of it is to level it all down to a flat ratio. That is not the purpose, because if it were we would say after they got 8 percent or 10 percent they would take it off.

Mr. SARGENT. I would rather say the tendency, rather than the purpose, Senator.

Senator CONNALLY. When you quote somebody and use it as an argument you are supposed to approve it. Then you do not approve what Senator McAdoo says, do you?

Mr. SARGENT. Yes, I do. He says:

The excess-profits tax must rest upon the wholly indefensible notion that it is a function of taxation to bring all profits down to one level with relation to the amount of capital invested, and to deprive industry of foresight and sagacity of their fruits.

Senator CONNALLY. You approve that?

Mr. SARGENT. I approve the statement; yes, sir. I do not approve the theory, but I approve the statement.

Senator CONNALLY. I do not get the distinction.

Mr. SARGENT. The Secretary did not approve the theory, either.

Senator CONNALLY. I do not know anybody that holds that theory.

Mr. SARGENT. The Secretary believed at that time, in the light of that experience, that those who passed the tax had that theory, that that evidently was the prevailing theory.

Senator CONNALLY. You are aware that President Wilson advocated the excess-profits tax as a permanent system on the taxing bills?

Mr. SARGENT. I will point out that three Secretaries of the Treasury, in the same administration, recommended its repeal.

Senator CONNALLY. I am not talking about that, I am talking about President Wilson's statement.

Senator KING. May I interrupt you?

Mr. SARGENT. Yes, sir.

Senator KING. Did not Mr. Parker's statement rest, however, largely upon the difficulty of ascertaining the capital investment?

Mr. SARGENT. Well, he was referring, of course, to the tax as it had existed. That was one of the difficult problems at that time; yes, sir.

Senator KING. You appreciate the difficulty he experienced in ascertaining, or attempting to ascertain, capital investment?

Mr. SARGENT. Yes, sir.

Senator KING. With all of the factors for depreciation, obsolescence, and so forth, which were involved in that determination.

Mr. SARGENT. That is right.

Senator KING. As the result of which in some corporations, as I recall, the experts so differed that one would give two or three hundred million dollars, one corporation that I have in mind, they would give a larger valuation of capital investment in one than in another.

Mr. SARGENT. That is correct; yes, sir.

Senator KING. That would be particularly true with respect to petroleum resources or reserves.

Mr. SARGENT. The depletion problem is a very complicated one; yes, sir.

Senator KING. Proceed.

DIFFICULTIES OF ADMINISTRATION

Mr. SARGENT. We submit further that, even if it were possible to meet all of the objections to the theory of an excess-profits tax with the exception of the underlying theory that there is a normal rate of profit, it becomes exceedingly difficult from a practical standpoint to administer the tax. Fortunately we do have some experience to go on with reference to this. It may be pointed out in the first place that, although a large number of nations, beginning in 1916, enacted excess-profits tax, now there are only three countries having excess-profits taxes—Rumania, Peru, and Yugoslavia. Eight countries—British India, New Zealand, Austria, Belgium, Latvia, Danzig, Lithuania, and Czechoslovakia—have surtaxes which are imposed on corporation income taxes, but these surtaxes, are not related in any way to the percentage of profit earned upon invested capital. We may note here, however, that the Spanish industrial corporation income tax is related to profits upon invested capital. We may note also that Argentina and Chile levy a surtax on foreign corporations, and that Chile and Peru levy surtaxes upon income not distributed to natural persons.

We may well ask ourselves why it is, if excess profits are such a prolific and easy source of revenue, that they have been repealed in practically all countries. I venture to assert that it is because they eventually realized that the taxes were unsound in principle, and because they were found to be difficult of administration. L. H. Parker, of the Joint Committee on Internal Revenue Taxation, declared with reference to the United States law which was repealed that—

The reason for its abandonment was because it was complicated, uncertain and extremely difficult of administration.

(Report on Double Taxation prepared for the subcommittee of the House Ways and Means Committee, 1932, p. 84.)

Prof. T. S. Adams, of Yale University, Chairman of the Advisory Tax Board of the Treasury, reviewing experience under the excess profits tax declared (1919 proceedings of National Tax Association, p. 306):

The excess profits tax is exceedingly difficult to administer. It is particularly difficult to measure, accurately and equitably, the invested capital, upon which the principal exemption or credit is based. What is the invested capital upon which it is desired to allow a reasonable return, free of tax? Does it include the unearned increment of land, appreciation in the value of securities, mineral and similar values brought to light by development, good will and like intangible values, created by high earning power? These and many similar difficulties surround the practical application of the excess profits tax. As a working measure of taxation, is it fit to survive? The more one knows about the actual operation of this tax, the more cautious he will be in answering this question. The doctrinaire, the taxpayer who knows the circumstances of his own case and no other, the all-wise publicist, with an instant opinion on every important problem, ready like postum, in 1 minute—will answer it lightly. Those who have studied the operation of the tax in thousands of cases will hesitate to pronounce an opinion. The tax has the merit of being wonderfully productive. It is better than no tax at all—better than bonds to an equivalent amount. But it is decidedly not worth preserving for its own sake.

We have called to your attention the statement by Senator William G. McAdoo when Secretary of the Treasury to the effect that an excess-profits tax rests upon a "wholly indefensible notion." We

now further direct your attention to the fact that two additional Secretaries of the Treasury recommended repeal of the excess-profits tax on the ground that it was impossible of administration:

Thus we find that David F. Houston in the report of the Treasury Department for the fiscal year ending June 30, 1920 declared:

The reasons for the repeal of the excess-profits tax should be convincing even to those who on grounds of theory or general political philosophy are in favor of taxes of this nature. The tax does not attain in practice the theoretical end at which it aims. It discriminates against conservatively financed corporations and in favor of those whose capitalization is exaggerated; indeed, many over capitalized corporations escape with unduly small contributions. It is exceedingly complex in its application and difficult of administration, despite the fact that it is limited to one class of business concerns—corporations. Moreover, it is rapidly losing its productivity. (Annual Reports on Finance for 1920, Treasury, p. 38.)

In a statement of March 17, 1920, Secretary Houston declared (letter to House Ways and Means Committee):

The application or calculation of the excess-profits tax is so complex that it has proved impossible to keep up the administrative work of audit and assessment.

Secretary of the Treasury Carter Glass, now a distinguished Senator from the State of Virginia, declared in his annual report as Secretary for the fiscal year ending June 30, 1919 (pp. 23 and 24):

The Treasury objections to the excess-profits tax even as a war expedient (in contradistinction to a war-profits tax) have been repeatedly voiced before the committees of the Congress. Still more objectionable is the operation of the excess-profits tax in peace time. It encourages wasteful expenditure, puts a premium on overcapitalization and a penalty on brains, energy, and enterprise, discourages new ventures, and confirms old ventures in their monopolies.

We submit that an excess-profits tax has proved in practice difficult to administer and that even if such a tax could be successfully administered, that it should be opposed as essentially unsound in principle.

TAX ON UNDISPUTED PROFITS

The proposal for a tax on undistributed profits has been thus presented to Congress:

Ultimately, we should * * * through taxation * * * discourage unwieldly and unnecessary corporate surpluses. (Presidential message, June 19).

So far as I am aware, this is the first time since 1920 that the proposal for a tax on corporate surpluses or undistributed profits has been seriously proposed. It is a tax which has no precedent in this country (such a tax is not to be confused with the provision of our present tax laws providing for a surtax on corporations improperly accumulating a surplus in order to evade taxation) and it exists in only two foreign countries, Belgium and Norway.

Questions which immediately arise relate to determination as to when a surplus is unwieldly and when it is unnecessary. In all my contacts with industrial executives, I have never known any of them to declare that an existing surplus was unwieldly, and I know of no industrial leader who believes that a surplus is unnecessary.

I believe further that industrial executives with their responsibility to stockholders for the maintenance of property and security of investment would regard as economic folly any decision to turn over to political appointees the right to determine how large a corporation surplus should be, and decision as to when a surplus was either unnecessary or unwieldly.

We submit that the recent economic history of this country demonstrates the value to the country of corporate or business surpluses. According to reports of the Bureau of Foreign and Domestic Commerce covering the 4 years—1930 to 1933 inclusive, the business interests of this country paid out over 27 billion dollars (\$27,198,000,000) more than they received in income. During the 3 years, 1930 to 1932, inclusive (figures for the year 1933 not being available in this case) manufacturing corporations of the country disbursed over 7 billion dollars (\$7,164,000,000) more than they received as income. (During this same period all business corporations disbursed 23 billion dollars in excess of their income.)

It may be asked now it was possible for industry to make such disbursements and the answer can only be that these disbursements could not have been made if business surpluses had not existed. These surpluses were used to maintain interest payments, in some cases to pay dividends, and in many cases to continue employment of workers where there was no real work available. One of the effects of the imposition of such a tax would necessarily be to throw upon Government agencies the care of thousands of workers whose interests are otherwise cared for by industrial employers.

From an economic standpoint we may list the following objections to proposals to tax surpluses or undistributed profits simply because they exist at all, or because they exceed some specified amount or percentage.

(1) Surpluses or undistributed profits constitute potential but not actual income to the stockholders who own the corporation. The economic principle herein involved was thus stated by the present Chief Justice of the United States Supreme Court as attorney for a defendant taxpayer in 1920 (*Eisner v. Macomber*, 252, U. S. 198):

Undistributed corporate profits are not income to the stockholder. It is the essence of income that it should be realized. Potentiality is not enough * * * The increase of the forest is not income until it is cut. The increase in the value of lands due to growth and prosperity of the community is not income until it is realized * * * This is sound doctrine both in law and in economics. Income of a corporation is not income of the shareholder until distributed.

(2) Any effort to collect a tax at a high or substantial rate on the undistributed profits retained by corporations in good years may result in serious economic losses, and even perhaps bankruptcy in industries in which profits vary widely from year to year; that is, where there are some years when the corporation practically breaks even. In these industries where there is great variation from year to year, it is absolutely necessary for the corporation to accumulate large surpluses during the years of good profits in order to meet the situation arising in other years.

(3) A system of large taxation of undistributed profits in any year will bear with great hardship upon young industries and upon growing industries. These industries ordinarily find themselves obliged for many years to put back into the business a large amount of the profits, not only to keep the enterprise going but in order to provide for development.

(4) To the extent that undistributed profits represent reinvested profits, the proposed tax would be a tax on investments made in the hope of future dividends.

(5) Young and developing industries, particularly those based upon constructive inventions, may very often earn large rate of return,

while large concerns, having already established themselves, are apt to earn at a lower rate upon investment, due partly to having a more stable business. Under such a condition either a flat tax or a progressive tax upon undistributed profits related to percentage of profits upon invested capital will react to the detriment of the young and growing firms of the country, and in favor of entrenching the position held by large industrial concerns.

(6) It is generally recognized among authorities on corporation finance that it is a mistake for a company, except under very unusual circumstances, to distribute over a period of years over about one-half of profits. The retention of the remainder of profits in the company not only permits growth, but tends to permit maintenance of fairly stable dividend rates throughout a period of years. It also permits a well established company to meet those vicissitudes which all corporations are bound to experience in the course of several decades.

It is difficult to conceive how a more uneconomic measure than a tax on undistributed profits could be considered by the American people. It would be a thoroughly uneconomic tax which would lead to economic disaster since it would put a premium on unsound financial policies of business corporations.

CONCLUSIONS

We agree with Governor Eccles in his statement made only a few months ago: "Any substantial increase in taxes at the present time" might tend to "reduce private spending" by pulling into the Treasury money which would otherwise be spent by private industry. We believe that every possible encouragement should be given by Congress to private industry in its desire to expand operations and increase private employment. We believe that recovery will only exist in the United States when we have a substantial increase in private employment. We naturally favor restoration of a balanced budget, and believe every possible effort should be made to accomplish this by reducing Government costs to fit reasonable taxes. We believe that at any time Congress should avoid enactment of tax laws which embody unsound principles.

This committee now has before it proposals which, in our opinion, do embrace uneconomic tax principles. Taxes upon corporations are taxes upon individual stockholders. A graduated corporation income tax not only violates the "ability to pay" principle, but may in practice actually result in regressive instead of progressive taxation, with the consequences that those less able to pay will be taxed at a higher rate. The excess-profits tax upon corporation earnings is not only unsound in attempting to define a normal rate of profit for all industry, but experience demonstrates that it is more difficult to administer than any other major tax which this country has ever experienced. The proposal for a tax on undistributed profits is a proposal to tax caution and to penalize sound financial policies practiced by industrial corporations.

We urge this committee to reject proposals for the enactment of any tax embodying unsound doctrines, and which are, in many instances, as a distinguished Secretary of the Treasury, now Senator from California, declared, "wholly indefensible."

SUPPLEMENTARY MEMORANDUM

(To July 1, 1935)

(1) Foreign nations with corporation income taxes.

Flat rate.—Australia, British India, Canada, Great Britain, Union of South Africa, Austria, Czechoslovakia, Danzig, Germany, Greece, Italy, Lithuania, Netherlands, Norway, Portugal, Rumania, Yugoslavia, Japan, Argentina (foreign corporations only), Brazil, Cuba, Ecuador (foreign corporations and closed corporations) Guatemala, Puerto Rico.

Graduated rates.—New Zealand, Denmark, Estonia, Finland, France, Hungary, Latvia, Lithuania (only on firms not keeping books), Luxemburg, Poland, Spain, Sweden, Chile, Colombia, Costa Rica, Haiti, Mexico, Panama, Paraguay Salvador.

Taxes on undistributed profits.—Belgium, Norway.

Excess-profits taxes.—Rumania, Yugoslavia, Peru (flat rate only; progressive rates only when incomes not distributed to natural persons).

(2) States with graduated corporation income taxes—Arizona, Idaho, Minnesota, Mississippi, South Dakota, Wisconsin.

The CHAIRMAN. All right, Mr. Sargent, thank you. Mr. R. V. Fletcher.

Senator HASTINGS. When the Interstate Commerce Committee was considering the holding company bill, I proposed an amendment which would permit the holding companies to consolidate, or do away with as many of them as possible. That tax necessarily involved, when they tried to get rid of the holding company, that it should be eliminated for a certain number of years, and all the members of the committee present at that time thought that ought to be done, but thought it ought not be put in the holding company bill but ought to be in this tax bill. I just wanted to make a suggestion and see whether the members of the committee generally have agreed on it, so we might prepare some such amendment as that. I am told that many of these holding companies would be eliminated except for the tax feature.

Now, if it be true, as the President has emphasized, not only in the utility field but in the corporation field generally, that we ought to do what we can to eliminate many of the holding companies, it seems to me that Congress ought to offer some inducement to them to do it voluntarily, and the best way to do that is to provide that within a certain length of time there should be no Government tax imposed upon companies that desire to eliminate the holding company.

Senator BARKLEY. You are talking about the transfer taxes?

Senator HASTINGS. Yes.

Senator BARKLEY. Made necessary by the transfer of stock?

Senator HASTINGS. Yes.

Senator BARKLEY. You do not mean taxes on other matters, you do not mean the elimination of general taxes?

Senator HASTINGS. Not at all; but my understanding is that there are some of these holding companies, for instance, where the stockholders own this stock purchased years ago, that they had to transfer that stock into some other kind of security, and there falls an income tax on it, and there would be a tax on the gain or on the profit.

Senator BARKLEY. Most of them would be charging off losses.

Senator HASTINGS. Those are the things that ought to be eliminated. Of course, there ought to be a time limit put on it, a year or three years, something like that. I intended to make a suggestion to somebody in the House before the bill got here in reference to that.

The CHAIRMAN. That matter was presented by the holding company bill. I thought there was great force in the proposition. If the Government was going to force liquidation of these holding companies it ought not at the same time force them into a position that would make them pay an increased tax. I thought it was pretty generally understood. I talked to Senator Wheeler on that proposition and he was of that opinion. I thought we were going to take care of that in the holding company bill. If it is not taken care of in conference, and it is in such a position that it cannot be considered, I think there ought to be legislation on it.

Senator BARKLEY. It cannot be considered in conference.

The CHAIRMAN. Then Mr. Parker and these gentlemen ought to get some amendment as rapidly as they can on it.

Senator BARKLEY. Furthermore, the Senate could not consider it because it was a revenue matter and could not originate in the Senate.

Senator HASTINGS. I think we ought to go a step further and not be limited to companies that are forced to do a certain thing. If it is true these holding companies are getting to be a thing that ought not to exist in America, as the President thinks, it seems to me we ought to offer that inducement to other industries outside of the utility field.

The CHAIRMAN. Mr. Parker, will you and your experts make a study on that?

Mr. PARKER. Yes, sir; and we have already done some work on it, in anticipation it would go in the holding company bill in the House. They did not put it in on account of striking out the so-called "death-sentence" clause.

Senator HASTINGS. It was suggested, Mr. Chairman, that we attach it to the tax bill.

The CHAIRMAN. All right, Judge Fletcher.

STATEMENT OF R. V. FLETCHER, ASSOCIATION OF AMERICAN RAILROADS, WASHINGTON, D. C.

The CHAIRMAN. Judge Fletcher, you represent the Association of American Railroads?

Mr. FLETCHER. That is right. The association of American Railroads which I represent here has in its membership about 99 percent, I think, of the mileage of the class 1 railroads of the United States, and they also have in their ranks the principal railroads in Canada and Mexico, but of course we are concerned here with the railroads in the United States.

The CHAIRMAN. I am concerned only with so much of the matter being considered by the committee as relates to taxes upon railroads. The other features of the proposition may be important, but they are not within my province to discuss.

The bill, as it came over from the House, or the bill that has been introduced in the House, rather, H. R. 8974, takes care of the situation so far as the railroads are concerned in a fairly satisfactory manner. So if I were sure this committee would consider only H. R. 8974 and adopt the suggestion of the Ways and Means Committee of the House as to how a railroad corporation should be taxed I would be spared the trouble of making any representations to the committee.

Senator KING. You may very briefly state just what the taxing provision is as found in the House bill.

Mr. FLETCHER. In the House bill, so far as railroads are concerned, it is provided inasmuch as the railroads under the tax act of 1934 are permitted to make a consolidated return, with a 2 percent penalty for the privilege of making a consolidated return, that any corporation permitted to make a consolidated return shall not pay a higher rate, shall not have a higher rate imposed upon it than 15¼ percent.

The CHAIRMAN. That is the rate fixed in the bill.

Mr. FLETCHER. It was stated in a little different way. Since the general tax rate was 13¾, and adding the 2 percent penalty to it, that gives you 15¼. This provides that any corporation having the right to make a consolidated return shall pay 15¼. So it is not to increase the taxes on railroads if they saw fit to make a consolidated return.

Senator KING. On excess profits?

Mr. FLETCHER. The excess profits is a different proposition.

Senator HASTINGS. That does not interest the railroads.

Mr. FLETCHER. It might, under certain conditions. I would like to make one other suggestion about that. There is a one-half of 1 percent increase in the rate on the railroads that do not see fit to make a consolidated return. That would amount to some increase on some railroads, I am quite sure, but in view of the general disposition of the Congress and of the country, apparently, to increase taxes, I think the railroads ought to be fairly well satisfied with the House provision. However, I am not at all sure, Mr. Chairman, that I would be safe in resting it there.

The CHAIRMAN. We better let sleeping dogs rest. I do not think it is the desire on the part of anyone, as far as I have heard, or any disposition to change that. If there is, you just better file your brief.

(The following memorandum was subsequently submitted:)

MEMORANDUM

This statement is filed on behalf of the association of American Railroads by its vice president and general counsel.

This association is a voluntary one, organized for the purpose of promoting the interests of the class I railroads of the United States, Mexico, and Canada. A class I railroad is one which has operating revenues annually of \$1,000,000 or more. The association has in its membership about 99 percent of the mileage of the class I railroads of the United States.

INCOME TAX ON CORPORATIONS

On July 9, 1935, the author of this memorandum was permitted to make a statement before the Committee on Ways and Means of the House of Representatives with respect to the subject matter of the message submitted by the President of the United States to Congress on June 19, 1935, in which message the President suggested certain changes in tax methods and policies. The statement on behalf of the Association covers about 15 pages of the printed record of hearings before the Ways and Means Committee.

In that statement it was pointed out by the author of this memorandum that there is no basis, either in reason or experience, for a progressive graduated scale applicable to the income of corporations. It is not necessary here to repeat the argument made before the House committee as to the reasons why the net income of corporations should not be subjected to a progressively increasing rate.

Every recognized authority upon the subject of taxation agrees that since a corporation is merely an aggregation of individuals who have pooled their resources for business purposes and since it is the legal obligation of a corporation to distribute its earnings among the stockholders after payment of expenses, interest, taxes, etc., there could be no equity in taxing the net income of a large corporation at a higher rate than is applied to the net income of a small corporation. In other words, no good reason has yet been given why a man who has invested

\$1,000 in the capital stock of a large corporation should receive a smaller net income than the one who has invested \$1,000 in the capital stock of a small corporation. All students of the question are agreed that in fairness the tax should be imposed in accordance with the ability to pay and this ability cannot be judged except by tracing the money back to the stockholder and ascertaining his other sources of income.

Aside from the inequity as to corporations generally of applying a progressive graduated scale, such a method is particularly unfair as applied to railroads. The railroads are entitled to special treatment in this respect, for the reason that it is the settled policy of the Government that they should be consolidated into a few comparatively large systems. The Transportation Act of 1920 recognizes this principle and makes it the duty of the Interstate Commerce Commission to create a limited number of railroad systems, upon the theory that large railroads can be operated more economically and efficiently than small railroads. The Commission was engaged for many years in preparing a plan whereby all the railroads of the United States would be consolidated into 19 railroad systems. Every President of the United States since 1920 has recommended to Congress or has given public expression to the thought that railroad consolidations should go forward in the interest of economy. The Federal Coordinator of Transportation, in his several reports to Congress, has dealt with the subject and while he has not favored wholesale consolidations as advocated by many students of the subject, he has recommended a plan where consolidations would be compulsory in the event that the Interstate Commerce Commission found them desirable in particular cases.

It would seem, therefore, to be highly inconsistent for Congress to provide by legislation for the consolidation of railroads into large systems and, at the same time, impose a penalty for such consolidations by adopting a progressive graduated income tax.

The Committee on Ways and Means, apparently recognizing the injustice which would be done to the railroads by such a plan, has provided in H. R. 8974 that railroads making a consolidated return should not be required to pay a greater tax than they pay now, which is 15¾ percent. This last-named figure is the amount obtained by adding to the current 13¾ percent rate a 2 percent penalty carried in the 1934 statute and applicable to railroads alone. The situation is made clear in the report made by Chairman Doughton, bearing date of July 30, 1935, in which H. R. 8974 is reported to the House. It is there said on page 7:

"Section 102 (b) provides for the rate of tax in the case of railroads filing consolidated returns. Under the Revenue Act of 1934 only railroads may file consolidated returns and then only under certain conditions. If permitted to file such returns, and if they do so, they pay under existing law a rate of 15¾ percent instead of 13¾ percent. Your committee is of the opinion that it is unnecessary to provide for a graduated corporation tax on railroads if they file a consolidated return, and therefore it is recommended that, if the railroads file a consolidated return, they be required to pay a flat tax of 15¾ percent on their entire net income. Of course, if they do not file the consolidated return, then they will be subject to the graduated rates of 13¾ and 14¾ percent. It will be noted that the rate required on the consolidated return of 15¾ percent is still substantially above the maximum rate of 14¾ percent required to be paid by corporations not filing consolidated returns. The bill makes no change in the present law as to the exercise of the privilege of filing consolidated returns."

It is true that if railroads do not elect to file consolidated returns or if their position is such that they cannot do so by reason of the absence of affiliates, they will be subjected to an increased tax of one-half of 1 percent. We object seriously to any increase at this time in railroad taxes and submit that there should be no penalty placed upon railroads merely because they are large. If it be thought that huge corporations are socially and economically objectionable, certainly it cannot be said that the public interest would be subserved by breaking up railroad companies into smaller units. The commerce of the country would not be helped by any program which would cause the New York Central Railroad between New York and Chicago to be broken up into what were once its component parts. No one would be benefited by having to ride from New York to Albany on one railroad, from Albany to Buffalo on another, from Buffalo to Cleveland on a third and from Cleveland to Chicago on a fourth.

In the representations made by the association to the House Committee certain statements were filed to which we should like to call attention here. One of these, which we append to this memorandum marked "Exhibit A", is the

income account of the railways of class I in the United States for the years 1929 to 1934, inclusive. It will be seen from this statement that whereas the railroads in 1929 had a net income of \$896,800,000, this progressively declined so that in 1934 there was a deficit after fixed charges of \$32,300,000. The worst year was 1932, when there was a deficit of \$139,200,000. It will be seen from this statement that railroad tax accruals have also progressively declined.

We are also filing as exhibit B a statement which is found on page 87 of the House hearings dealing with the classification of the railroads for the years 1929 to 1934 as among those where there was a net income and those where there was a loss. It will be seen that whereas in 1929, 98 systems operated at a profit and 20 at a loss, in 1934 only 43 operated at a profit and 74 at a loss.

We also file as exhibit C a statement showing what certain railroads would have paid in 1934 on the basis of a progressive sliding scale beginning at 10 percent and ending at 17½ percent, provided these roads had each made an individual and not a consolidated return. This statement is found at page 88 of the House hearings. It shows that the Chesapeake & Ohio would be the hardest hit of any of the railroads being subjected to a 17½ percent tax, the Norfolk & Western would be second, the Pennsylvania Railroad third, etc.

Upon the theory that Congress is legislating not only for the distressed present but for the future, when conditions may be more normal, we are also filing as exhibit D the table which appears at pages 90 and 91 of the House hearings, showing what would be the effect of the sliding scale, beginning at 10 percent and ending with 17½ percent, upon the 1930 basis of earnings. In this table 1930 is, for the purpose of the presentation, considered as a fairly normal year.

In addition to the tables mentioned, all of which were presented to the House committee, we also present as exhibit E a table showing what would be the cost to the railroads of an increase of one-half of 1 percent, based on the Federal income tax accruals for 1934. In this statement those railroads opposite the name of which a star (*) appears are those which made a consolidated return in 1930, when the penalty for doing so was only 1 percent. We are unable at this time to say just what railroads did in 1934 make consolidated returns.

EXCESS-PROFITS TAXES

The spokesman for the association made no statement with reference to excess-profits tax when he appeared before the Ways and Means Committee of the House. At the time of the House hearings, no bill had been prepared. There was nothing in the President's message dealing with excess-profits tax. The Ways and Means Committee had adopted a resolution that witnesses before the Committee should confine themselves to the President's message. It is appropriate, therefore, that some reference should be made in this memorandum to the excess-profits-tax plan carried in H. R. 8974.

The report presented by the majority of the Ways and Means Committee contains the following statement:

"The adjusted declared value of the capital stock of a corporation has already been provided for under the Revenue Act of 1934. In the first instance, the corporation was permitted to declare any value for its stock which it saw fit. Having declared such a value on its capital stock, the value may be increased or diminished only on account of bona fide additions to or subtractions from its capital. The present combination capital-stock and excess-profits tax was first imposed by the National Industrial Recovery Act of 1933. The taxes were reimposed by the Revenue Act of 1934 and a new declared value allowed. Your committee does not provide in this bill for another original declared value, being of the opinion that since the corporations have already had two opportunities to set a proper value on their capital stock, it would be unnecessary from an equitable standpoint to provide another original declaration."

It is our contention that the bill should provide for the privilege of making another original declared value. In the act of 1934 it is provided that the value of the capital stock shall be declared by the corporation. In that act the capital stock tax was fixed at 1 percent of whatever value was declared, with an excess profits tax of 5 percent on all profits in excess of 12½ percent of the declared value. Obviously, corporations in declaring a value were justified in taking into consideration the relation between the capital-stock tax on the one hand and the excess-profits tax on the other. The act does not provide for ascertaining the real value of the capital stock and in effect corporations were permitted to declare without question any value they saw proper. Obviously, ordinary business judgment would dictate that such a value be selected as would impose the lowest tax. It is

now proposed to change the excess-profits tax very materially so as to begin the 5 percent tax at 8 percent and increase it progressively.

We should like to call attention to an illustration as to how this may work out. If a corporation declared a value of \$70,000,000 on its capital stock in 1934, it would pay a capital stock tax of \$70,000. In this year the company might earn \$10,000,000. Under the law as it stands now, the corporation would pay a normal tax of 13¼ percent on this \$10,000,000 or \$1,375,000, a capital stock tax of \$70,000, an excess-profits tax of \$62,500, or a total of \$1,507,500. Under the proposed legislation, if \$10,000,000 were earned this year, as pointed out in the above illustration, the corporation, if it did not make a consolidated return, would pay income tax of 14¼ percent or \$1,425,000, a capital stock tax of \$70,000, an excess-profits tax of \$300,000, or a total tax of \$1,795,000. It is obvious that if the corporation had declared the value of its capital stock to be \$100,000,000 instead of \$70,000,000, while its capital stock tax would have been increased by \$30,000, its excess-profits tax would be so decreased as to make it more to the interest of the company to declare the higher value of \$100,000,000 rather than the lower value of \$70,000,000.

We submit, therefore, that the railroads, and other corporations for that matter, should have the privilege of declaring a new value in the light of changed conditions. It is our understanding that this matter has been dealt with more at length and orally by a witness representing the Chamber of Commerce of the United States.

Respectfully submitted.

ASSOCIATION OF AMERICAN RAILROADS,
By R. V. FLETCHER,
Vice President and General Counsel.

EXHIBIT A.—*Income account, railways of class I, United States, calendar years 1929 to 1934*

[Figures in millions of dollars]

Item	1929	1930	1931	1932	1933	1934
Average miles of road operated.....	241,583.85	242,185.61	242,175.83	241,519.24	240,624.00	239,051.47
Total operating revenues.....	\$6,279.5	\$5,281.2	\$4,188.3	\$3,126.7	\$3,095.4	\$3,271.4
Total operating expenses.....	\$4,506.0	\$3,930.9	\$3,223.6	\$2,403.4	\$2,249.2	\$2,441.8
Operating ratio (percent).....	71.76	74.43	76.97	76.87	72.66	74.64
Net operating revenue.....	\$1,773.5	\$1,350.3	\$964.7	\$723.3	\$846.2	\$829.6
Railway tax accruals.....	\$396.7	\$348.6	\$303.5	\$275.1	\$249.6	\$239.5
Uncollectible railway revenues.....	\$1.2	\$1.0	\$0.9	\$1.0	\$1.2	\$1.1
Equipment rents, net debit.....	\$95.4	\$99.8	\$99.2	\$85.1	\$85.0	\$89.8
Joint facility rents, net debit.....	\$28.5	\$32.0	\$35.5	\$35.8	\$36.1	\$36.5
Net railway operating income.....	\$1,251.7	\$868.9	\$525.6	\$326.3	\$474.3	\$462.7
Rate of return on property investment (percent).....	4.84	3.30	2.00	1.25	1.83	1.77
Other income.....	\$359.7	\$358.9	\$305.6	\$224.5	\$211.0	\$182.4
Total income.....	\$1,611.4	\$1,227.8	\$831.2	\$550.8	\$685.3	\$645.1
Interest on funded debt.....	498.6	496.3	500.2	500.0	498.3	} 522.9
Interest on unfunded debt.....	12.7	12.5	17.8	24.6	26.2	
Rent for leased roads.....	177.4	170.6	170.7	138.0	150.2	
Other deductions.....	25.9	24.5	27.8	27.4	16.5	
Total deductions.....	714.6	703.9	696.5	690.0	691.2	677.4
Net income.....	896.8	523.9	134.7	¹ 139.2	¹ 5.9	¹ 32.3

¹ Deficit.

EXHIBIT B.—*Net income or net deficit after fixed charges, railways of class I, United States*

Year	Number	Miles	Percent of class I mileage	Net deficit and net income
Systems operating at a loss:				
1929.....	20	10, 180.06	4. 21	¹ \$10, 641, 670
1930.....	36	39, 089.37	16. 14	¹ 41, 809, 544
1931.....	64	101, 995.67	42. 12	¹ 102, 934, 535
1932.....	86	163, 847.46	67. 84	¹ 247, 390, 944
1933.....	71	138, 617.30	57. 61	¹ 152, 632, 509
1934.....	74	146, 544.01	61. 30	¹ 155, 642, 722
Systems operating at a profit:				
1929.....	98	231, 318.39	95. 75	907, 448, 281
1930.....	83	202, 983.84	83. 82	565, 717, 016
1931.....	54	140, 094.76	57. 85	237, 696, 446
1932.....	31	77, 277.09	32. 00	108, 187, 125
1933.....	46	101, 372.17	42. 13	146, 739, 672
1934.....	43	91, 879.04	38. 43	123, 391, 540
Total, all systems: ²				
1929.....	120	241, 583.85	100.00	896, 806, 611
1930.....	120	242, 158.61	100.00	523, 907, 472
1931.....	119	242, 175.83	100.00	134, 761, 911
1932.....	119	241, 519.24	100.00	¹ 139, 203, 819
1933.....	120	240, 617.89	100.00	¹ 5, 862, 837
1934.....	120	239, 051.47	100.00	¹ 32, 251, 182

¹ Deficit.² Includes a few companies reporting no income or deficit.

EXHIBIT C.—*Estimated Federal income tax at rates proposed June 25, 1935, for those class I carriers paying Federal income taxes in 1934*

Road	Estimated income on which tax was paid ¹	Federal income tax accrued 1934	Estimated Federal tax at proposed rates	
			Rate (per-cent)	Tax
Chesapeake & Ohio.....	\$32, 182, 000	\$4, 425, 000	17½	\$5, 632, 000
Norfolk & Western.....	19, 818, 000	2, 725, 000	17	3, 369, 000
Pennsylvania R. R.....	19, 392, 000	2, 666, 352	17	3, 297, 000
Reading.....	7, 035, 000	967, 315	17	1, 196, 000
Union Pacific.....	6, 565, 000	902, 681	17	1, 116, 000
Delaware, Lackawanna & Western.....	3, 019, 000	415, 142	17	513, 000
Pittsburgh & Lake Erie.....	2, 729, 000	375, 241	17	464, 000
Virginian.....	2, 421, 000	332, 898	17	412, 000
Duluth, Missabe & Northern.....	1, 433, 000	196, 980	17	244, 000
Detroit, Toledo & Ironton.....	1, 391, 000	191, 258	17	236, 000
New York, New Haven & Hartford.....	1, 309, 000	180, 000	17	223, 000
Wheeling & Lake Erie.....	1, 184, 000	162, 774	17	201, 000
Cincinnati, New Orleans & Texas Pacific.....	996, 000	137, 000	16	159, 000
Bangor & Aroostook.....	996, 000	136, 943	16	159, 000
Montour.....	882, 000	121, 340	16	141, 000
Detroit & Toledo Shore Line.....	868, 000	119, 412	16	139, 000
Atchison, Topeka & Santa Fe.....	856, 000	119, 000	16	138, 000
Pennsylvania-Reading Seashore Lines.....	782, 000	107, 490	16	125, 000
Cambria & Indiana.....	625, 000	85, 946	16	100, 000
Oregon Short Line.....	611, 000	84, 000	16	98, 000
Baltimore & Ohio.....	563, 000	77, 373	16	90, 000
Bessemer & Lake Erie.....	447, 000	61, 500	16	72, 000
New York, Ontario & Western.....	415, 000	57, 000	16	66, 000
Texas & Pacific.....	400, 000	55, 000	16	64, 000
Lake Superior & Ishpeming.....	319, 000	43, 815	16	51, 000
Boston & Maine.....	263, 000	36, 225	15	39, 000
Monongahela.....	257, 000	35, 385	15	39, 000
Louisiana & Arkansas.....	240, 000	33, 000	15	36, 000
Toledo, Peoria & Western.....	221, 000	30, 346	15	33, 000
St. Joseph & Grand Island.....	202, 000	27, 814	15	30, 000
Clinchfield.....	200, 000	27, 545	15	30, 000
Kansas, Oklahoma & Gulf.....	160, 000	22, 000	15	24, 000
Chicago & Illinois Midland.....	139, 000	19, 092	15	21, 000
Lehigh & Hudson River.....	120, 000	16, 447	15	18, 000
Erie (including Chicago & Erie).....	96, 000	13, 210	14	13, 400

¹ Estimated by assuming Federal tax accruals to have been 13¾ percent of income.

EXHIBIT C.—Estimated Federal income tax at rates proposed June 25, 1935, for those class I carriers paying Federal income taxes in 1934—Continued

Road	Estimated income on which tax was paid	Federal income tax accrued 1934	Estimated Federal tax at proposed rates	
			Rate (percent)	Tax
Lehigh & New England.....	77,000	10,613	14	10,800
Columbus & Greenville.....	65,000	8,962	14	9,100
Nevada Northern.....	44,000	6,100	14	6,200
Tennessee Central.....	37,000	5,096	13	4,800
Charleston & Western Carolina.....	33,000	4,505	13	4,300
St. Louis-Southwestern Lines.....	29,000	4,025	13	3,800
Richmond, Fredericksburg & Potomac.....	28,000	3,900	13	3,600
Elgin, Joliet & Eastern.....	15,000	2,060	13	2,000
New York Connecting.....	7,000	950	12	840
Missouri-Illinois.....	6,000	870	12	720
Lehigh Valley.....	1,000	126	10	100
Utah.....	1,000	116	10	100
Total.....		15,054,847		18,634,760
Percent increase over tax of 1934.....				23.8

EXHIBIT D.—Estimated Federal income taxes at present rate of 13½ percent and at rates proposed based on taxable income of the calendar year 1930

[Railways of class I that accrued Federal income taxes in 1930]

Road	Estimated taxable income in 1930 ¹	Federal income tax at—			Increase over present rate	
		Present rate of 13½ percent	Proposed rate		Amount	Percent
			Rate (percent)	Tax		
New England region:						
Bangor & Aroostook.....	\$1,655,000	\$227,563	17	\$281,350	\$53,787	23.6
Boston & Maine.....	5,905,000	811,938	17	1,003,850	191,912	23.6
Central Vermont.....	175,000	24,063	15	26,250	2,187	9.1
Maine Central.....	761,000	104,638	16	121,760	17,122	16.4
New York Connecting.....	29,000	3,988	13	3,770	² 218	² 5.5
New York, New Haven & Hartford.....	10,338,000	1,421,475	17	1,757,460	335,985	23.6
Rutland.....	260,000	35,750	15	39,000	3,250	9.1
Great Lakes region:						
Ann Arbor.....	141,000	19,388	15	21,150	1,762	9.1
Delaware & Hudson.....	2,183,000	300,163	17	371,110	70,947	23.6
Delaware, Lackawanna & Western.....	7,993,000	1,099,038	17	1,358,810	259,772	23.6
Detroit & Toledo Shore Line.....	320,000	44,000	16	51,200	7,200	16.4
Erie.....	79,000	10,863	14	11,060	197	1.8
Lehigh & Hudson River.....	469,000	64,488	16	75,040	10,552	16.4
Lehigh & New England.....	238,000	32,725	15	35,700	2,975	9.1
Monongahela.....	505,000	69,438	16	80,800	11,362	16.4
New York Central.....	15,074,000	2,072,675	17	2,562,580	489,905	23.6
New York, Susquehanna & Western.....	742	102	10	74	² 98	² 27.3
Pittsburgh & Lake Erie.....	6,798,000	934,725	17	1,155,660	220,935	23.6
Wabash.....	297,000	40,838	15	44,550	3,712	9.1
Central Eastern region:						
Akron, Canton & Youngstown.....	63,000	8,663	14	8,820	157	1.8
Baltimore & Ohio.....	10,896,000	1,498,200	17	1,852,320	354,120	23.6
Bessemer & Lake Erie.....	3,464,000	476,300	17	538,880	112,580	23.6
Central R. R. of New Jersey.....	1,979,000	272,113	17	336,430	64,317	23.6
Chicago & Illinois Midland.....	9,167	1,260	12	1,100	² 160	² 12.7
Chicago, Indianapolis & Louisville.....	63,000	8,663	14	8,820	157	1.8
Elgin, Joliet & Eastern.....	293,000	35,750	15	39,000	3,250	9.1
Illinois Terminal.....	467,000	64,213	16	74,720	10,507	16.4
Long Island.....	9,683,000	1,331,413	17	1,646,110	314,697	23.6

¹ Based on Federal income tax accruals reported for 1930.

² Denotes decrease.

EXHIBIT D.—*Estimated Federal income taxes at present rate of 13¾ percent and a rates proposed based on taxable income of the calendar year 1930—Continued*

[Railways of class I that accrued Federal income taxes in 1930]

Road	Estimated taxable income in 1930	Federal income tax at—		Increase over present rate	
		Present rate of 13¾ percent	Proposed rate	Amount	Per cent
			Rate (per cent)	Tax	
Missouri-Illinois.....	31,000	4,263	13	4,030	² 233
Pennsylvania R. R.....	61,606,000	8,470,825	17½	10,781,050	2,310,225
West Jersey & Seashore.....	202,000	27,775	15	30,300	2,525
Western Maryland.....	2,142,000	294,525	17	364,140	69,615
Wheeling & Lake Erie.....	2,712,000	372,900	17	461,040	88,140
Poconos region:					
Chesapeake & Ohio.....	34,950,000	4,805,625	17½	6,116,250	1,310,625
Norfolk & Western.....	32,083,000	4,411,413	17½	5,614,525	1,203,112
Richmond, Fredricksburg & Potomac.....	1,153,000	158,538	17	196,010	37,472
Virginian.....	4,350,000	602,250	17	744,600	142,350
Southern region:					
Alabama Great Southern.....	1,000,000	137,500	17	170,000	32,500
Atlanta & West Point.....	37,000	5,088	13	4,810	² 278
Atlantic Coast Line.....	1,722,000	236,775	17	292,740	55,965
Charleston & Western Carolina.....	57,000	7,838	14	7,980	142
Cincinnati, New Orleans & Texas Pacific.....	1,998,000	274,725	17	339,660	64,935
Clinchfield.....	1,749,000	240,488	17	297,330	56,842
Columbus & Greenville.....	111,000	15,263	15	16,650	1,387
Georgia, Southern & Florida.....	95,000	13,063	14	13,300	237
Louisville & Nashville.....	2,999,000	412,363	17	509,830	97,467
Mississippi Central.....	11,767	1,618	12	1,412	² 206
Nashville, Chattanooga & St. Louis.....	666,000	91,575	16	106,560	14,985
New Orleans & Northeastern.....	21,000	2,888	13	2,730	² 158
Southern Ry.....	2,579,000	354,613	17	438,430	83,817
Tennessee Central.....	131,000	18,013	15	19,650	1,637
Western Ry. of Alabama.....	326,000	44,825	16	52,160	7,335
Northwestern region:					
Chicago & North Western.....	2,050,000	281,875	17	348,500	66,625
Chicago Great Western.....	292,000	40,150	15	43,800	3,650
Duluth, Missabe & Northern.....	5,988,000	823,350	17	1,017,960	194,610
Great Northern.....	4,167,000	572,963	17	708,390	135,427
Green Bay & Western.....	239,000	32,863	15	35,850	2,987
Lake Superior & Ishpeming.....	612,000	88,275	16	102,720	14,445
Northern Pacific.....	833,000	114,538	16	133,280	18,742
Central Western region:					
Alton.....	525,000	72,188	16	84,000	11,812
Atchison, Topeka & Santa Fe.....	37,381,000	5,139,888	17½	6,541,675	1,401,787
Chicago, Burlington & Quincy.....	20,395,000	2,804,313	17½	3,569,125	764,812
Chicago, Rock Island & Gulf.....	486,000	66,825	16	77,760	10,935
Chicago, Rock Island & Pacific.....	4,353,000	598,538	17	740,010	141,472
Denver & Rio Grande Western.....	813,000	111,788	16	130,080	18,292
Fort Worth & Denver City.....	967,000	132,963	16	154,720	21,757
Los Angeles & Salt Lake.....	120,000	16,500	15	18,000	1,500
Nevada Northern.....	199,000	27,363	15	29,850	2,487
Oregon Short Line.....	3,224,000	443,300	17	548,080	104,780
St. Joseph & Grand Island.....	598,000	82,225	16	95,680	13,455
Southern Pacific Co.-Pac. Lines.....	7,120,000	979,000	17	1,210,400	231,400
Toledo, Peoria & Western.....	274,000	37,675	15	41,100	3,425
Union Pacific.....	23,258,000	3,197,975	17½	4,070,150	872,175
Utah Ry.....	56,000	7,700	14	7,840	140
Southwestern region:					
Gulf, Colorado & Santa Fe.....	346,000	47,575	16	55,360	7,785
Kansas City Southern.....	504,000	69,300	16	80,610	11,310
Kansas, Oklahoma & Gulf.....	817,000	112,338	16	130,720	18,382
Louisiana & Arkansas.....	63,000	8,663	14	8,820	157
Midland Valley.....	333,000	45,788	16	52,280	6,492
Missouri-Kansas-Texas Lines.....	4,983,000	685,163	17	847,110	161,947
Missouri Pacific.....	3,458,000	475,475	17	587,860	112,385
St. Louis-San Francisco.....	164,000	22,550	15	24,600	2,050
Texarkana & Fort Smith.....	224,000	30,800	15	33,600	2,800
Texas & New Orleans.....	4,754,000	633,675	17	808,180	154,505
Texas & Pacific.....	3,193,000	439,038	17	542,810	103,772
Wichita Falls & Southern.....	54,000	7,425	14	7,550	135
Total.....		50,289,227		63,031,071	12,741,844
					24.5

² Denotes decrease.

EXHIBIT E.—*Estimated increase in Federal income tax account one-half of 1 percent provision for those class I carriers paying Federal income taxes in 1934*

Road	Estimated income on which tax was paid ¹	Federal income tax accrued, 1934	One-half of 1 percent	Estimated Federal tax including one-half of 1 percent provision
*Chesapeake & Ohio.....	\$32,182,000	\$4,425,000	\$160,910	\$4,585,910
*Norfolk & Western.....	19,818,000	2,725,000	99,090	2,824,090
*Pennsylvania R. R.....	19,392,000	2,666,352	96,960	2,763,312
*Reading.....	7,035,000	967,315	35,175	1,002,490
*Union Pacific.....	6,565,000	902,681	32,825	935,506
*Delaware, Lackawanna & Western.....	3,019,000	415,142	15,095	430,237
*Pittsburgh & Lake Erie.....	2,729,000	375,241	13,645	388,886
*Virginian.....	2,421,000	332,898	12,105	345,003
*Duluth, Missabe & Northern.....	1,433,000	196,980	7,165	204,145
Detroit, Toledo & Ironton.....	1,391,000	191,258	6,955	198,213
*New York, New Haven & Hartford.....	1,309,000	180,000	6,545	186,545
Wheeling & Lake Erie.....	1,184,000	162,774	5,920	168,694
Cincinnati, New Orleans & Texas Pacific.....	996,000	137,000	4,980	141,980
Bangor & Aroostook.....	996,000	136,943	4,980	141,923
Montour.....	882,000	121,340	4,410	125,750
Detroit & Toledo Shore Line.....	868,000	119,412	4,340	123,752
*Atchison, Topeka & Santa Fe.....	865,000	119,000	4,325	123,325
Pennsylvania-Reading Seashore Lines.....	782,000	107,490	3,910	111,400
Cambria & Indiana.....	625,000	85,946	3,125	89,071
*Oregon Short Line.....	611,000	84,000	3,055	87,055
*Baltimore & Ohio.....	563,000	77,373	2,815	80,188
Bessemer & Lake Erie.....	447,000	61,500	2,235	63,735
*New York, Ontario & Western.....	415,000	57,000	2,075	59,075
*Texas & Pacific.....	400,000	55,000	2,000	57,000
Lake Superior & Ishpeming.....	319,000	43,815	1,595	45,410
*Boston & Maine.....	263,000	36,225	1,315	37,540
Monongahela.....	257,000	35,385	1,285	36,670
Louisiana & Arkansas.....	240,000	33,000	1,200	34,200
Toledo, Peroia & Western.....	221,000	30,346	1,105	31,451
*St. Joseph & Grand Island.....	202,000	27,814	1,010	28,824
*Clinchfield.....	200,000	27,545	1,000	28,545
Kansas, Oklahoma & Gulf.....	160,000	22,000	800	22,800
Chicago & Illinois Midland.....	139,000	19,092	695	19,787
Lehigh & Hudson River.....	120,000	16,447	600	17,047
*Erie (including Chicago & Erie).....	96,000	13,210	480	13,690
Lehigh & New England.....	77,000	10,613	385	10,998
Columbus & Greenville.....	65,000	8,962	325	9,287
Nevada Northern.....	44,000	6,100	220	6,320
Tennessee Central.....	37,000	5,096	185	5,281
Charleston & Western Carolina.....	33,000	4,505	165	4,670
*Richmond, Fredericksburg & Potomac.....	28,000	3,900	140	4,040
Elgin, Joliet & Eastern.....	15,000	2,060	-----	2,060
New York Connecting.....	7,000	950	-----	950
Missouri-Illinois.....	6,000	870	-----	870
Lehigh Valley.....	1,000	126	-----	126
Utah.....	1,000	116	-----	116
Total.....	-----	15,050,822	547,145	15,597,967

Percent increase due to one-half of 1 percent provision, 3.6 percent.

¹ Estimated by assuming Federal tax accruals to have been 133½ percent of income.

Mr. FLETCHER. I do not want to take up your time and my time arguing some moot question. I have statements which I have put into the hearings in the House showing what this would mean to the railroads if you follow the suggestion of the chairman of this committee given to the press some time ago of having a sliding scale running from a minimum of 10 to a maximum of 17½, and we have those figures here; they are available for anybody.

The CHAIRMAN. Your statement is quite full in the record before the House Ways and Means Committee?

Mr. FLETCHER. Quite full. I am quite well satisfied with it, at least.

Another thing I want to say is on the excess profits tax. It does not seem fair to me, in fairness to the railroads and in fairness to the

industry generally, that they should not be given the privilege of making a new declaration of value.

Senator HASTINGS. That has not been given?

Mr. FLETCHER. That has not been given. Under the old law the question of what value you should declare for purposes of excess-profits taxes was largely an arbitrary figure. I imagine everybody sat down and took the capital stock tax of 1 percent, as I recall. And also the provision in the former law that you should put a 5-percent tax on all profits above 12½ percent, and they figured out a value which would make them pay as little tax as possible.

Senator CLARK. You allowed the corporation to make its own valuation on the theory it would make a fair valuation because if it made it too high it would get caught with one tax and if it made it too low it would get caught with another tax. If they made it on a fair basis, do you think it is fair to let them change it?

Mr. FLETCHER. Senator, I may be wrong, your information doubtless is better than mine but my impression is that was administered frankly on the theory that the corporation would have the right to select such value as would make it pay the least amount of tax.

Senator CLARK. The theory of it was that the corporation would sit down and arrive as nearly as possible at what the fair taxable basis was. Having done that, to let them change that basis simply because a tax is being imposed it seems to me as an erroneous theory.

Mr. FLETCHER. The only difference between us is the use of the word "fair." It was fair in the sense that this would protect the revenues, this basis they might select would protect the revenues in the best possible way. It balanced the tax on the capital stock against the tax on the excess profits. Now to change the whole basis of excess-profits tax and say that upon a declaration of value, which was made in one state of the law, should now be applied to a value where the state of the law changed entirely, it seems to me would be quite unfair. I would suggest to this committee something be written in the law which would permit a new declaration of value in the light of the changed statute.

Senator CONNALLY. Would you object to the change on the basis of the actual value?

Mr. FLETCHER. No; I would not, if it is practical.

Senator CONNALLY. Is it practical?

Mr. FLETCHER. It is practical in the case of the railroads, yes; to get the fair invested capital. I think that is fair to everybody.

Senator KING. However, during the last few years many of the railroads have suffered enormous losses in the value of their stock and in the value of their assets.

Mr. FLETCHER. Yes.

Senator KING. Many of them are in the hands of a receiver and many of them have been abandoned.

Mr. FLETCHER. There are about 60,000 miles in the hands of the receiver at the present time, more so than at any time before in the history of the country. The abandonment has been very small.

Senator KING. Several thousand miles of the Pennsylvania Railroad.

Mr. FLETCHER. Out of the 250,000 miles as now operated there has been a few thousand miles abandoned, mostly little lines and so forth.

The CHAIRMAN. Thank you Mr. Fletcher. Mr. H. B. Spalding of New York City.

STATEMENT OF H. B. SPALDING, (A. G. SPALDING & BROS.), VICE CHAIRMAN, TAXATION COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS, NEW YORK CITY

The CHAIRMAN. You are vice chairman of the taxation committee, National Association of Manufacturers?

Mr. SPALDING. Yes. You have got my name and position. I am also vice chairman of A. G. Spalding & Bros., manufacturers and distributors of athletic goods. I am appearing before you as vice chairman of the taxation committee of the National Association of Manufacturers. Because of the season, and the short time that the present proposed tax measures have been before Congress, my committee has had no opportunity to meet and express any opinion regarding them. Therefore, while the views I express will I believe be in general approved by that committee, they are for the present only an expression of my personal views on the subject.

The Constitution provides that revenue legislation shall originate in the House of Representatives. Legislative experience, however, has shown that while originating in the House it is usually in the Senate that tax laws receive the prolonged study and careful thought necessary to adopt them to the needs of the country and fiscal requirements of the Government. This procedure ordinarily has the advantage that when the Senate Finance Committee holds its public hearings, the House has debated and passed a tax bill. Thus witnesses can address themselves to a definite proposal that they have had the time to consider and study. In the present situation this advantage is lacking.

I can therefore only discuss the bill which was introduced in the House on Monday. It was reported in the newspapers on Tuesday. I have had only the opportunity to give it the most hasty examination, and cannot discuss the bill in detail.

In addition the motive behind the introduction of new tax laws at this time is not clear. These proposed taxes have been colloquially referred to as a "share-the-wealth program." From which it would appear that the motive behind them was to bring about some desired improvement in social conditions and general good of the greatest number. At the same time emphasis has been laid upon the necessity of increased revenue as a step toward a balanced budget. The latter is a quite different motive, and conclusions with respect to any particular tax will differ according to with which of these two motives it is approached. If one believes that inheritances above a certain amount are a social evil and should be prevented in the future by use of the taxing power, he will approve an inheritance tax that accomplishes that end regardless of the fiscal needs of the Government and also regardless of its effect on the future productiveness of other tax laws. The debate over such a law ceases to be one over revenue and fiscal requirements and becomes one dealing with a very broad social-economic problem.

The particular taxes to which I wish to address my remarks are the proposed taxes on corporations. These are taxes levied upon business enterprises, and upon a particular form, the corporation, under which business enterprise is conducted. To make clear what I have to say about the proposed taxes, I must set a background by discussing very briefly the nature of business enterprise and the corporate form for conducting it.

Fully realizing the danger of confusion in conveying ones meaning by the use of labels, I shall risk one, nevertheless, by referring to the economic system under which we live as the "profit-and-loss system".

Whether it is an individual, a partnership, or a corporation that starts a business enterprise, one or a group of persons invests his or their capital in the business assets necessary for the conduct of that enterprise in the hope that it will be successful (profitable) and that they individually will profit from the investment, but with the knowledge that if unsuccessful they will lose a part or maybe all that they have invested therein. That, in a sentence, is the essence of the "profit-and-loss system." It applies equally to a gigantic and socially essential enterprise such as the American Telegraph & Telephone Co. as to a peanut stand. Take away the right to profit from the investment, and unless guaranteed against loss, who would invest in any business enterprise? Guarantee against loss and the "profit-and-loss system" no longer exists. What you would have in its place you can label as you wish. But make no mistake, you would have made a revolutionary social-economic change, the total consequences of which are unpredictable.

The essential nature of a business enterprise does not differ whether conducted by an individual, a partnership, or a corporation. A corporation is merely a convenient piece of legal machinery to facilitate the consolidation in a single enterprise of capital contributed by several individuals, sometimes hundreds of thousands, and to provide for its management. The corporation is not only the most useful device so far known for establishing and conducting those enterprises which are economically practicable only when the units consist of very large aggregation of capital, but because of its convenience has been very extensively availed of for moderate sized and small enterprises. Assuming also that wide participation of ownership in the productive capital of the Nation is desirable it is the most convenient means to accomplish this end. Even the most ardent "wealth sharer" I am of course speaking only for a business corporation. A business enterprise, a charitable enterprise, or the conserving and investment of a personal fortune are three essentially different things. True, all three can be conducted under the corporate form. But while the form is the same, the substance is very different.

We have, therefore, this situation. Since the part of American business comparatively small enterprises as well as large ones, are conducted under the corporate form, taxes imposed on business corporations are essentially taxes levied on business enterprise. But if the taxes depend on the corporate form only and are not applicable to other forms under which business may be conducted, the limit can easily be reached whether the disadvantage of special corporation taxes offsets the advantage of the corporate form for conducting business. And such taxes, like the tax laid upon the circulation of State bonds will not produce revenue, but will prevent the use of the corporate form.

I am quite aware that corporations have been subjected to tax burdens both State and Federal from which individuals and partnerships were free, and that, nevertheless, corporations have grown in number, and an ever increasing proportion of the Nation's business is being carried on under the corporate form. This is proof of the very great convenience and usefulness of the corporate form of conducting business. Its use has grown in spite of the adverse tax discrimination to which it has been subjected. True high surtaxes on individuals' incomes has doubtless caused many individual businesses and partnerships to be incorporated. But incorporation has occurred too frequently in cases where high surtaxes were no factor to allege surtaxes as the principal cause of the increased use of corporations in business enterprises.

Senator CONNALLY. That is true of any tax; isn't it?

Mr. SPALDING. Yes, I think it is true of almost any tax levied on business enterprises, therefore in determining the kind of tax you have on the business enterprise it requires that you strike a fair balance between the evil on the one hand and the need for revenue on the other.

Senator CONNALLY. That is our purpose. According to your theory we would not have any taxes. You are against all taxes. It is easy to be against all taxes, but we have to have them. Any tax would deter, in a sense, from accumulating your profits and keeping them. That is true of the income tax.

Mr. SPALDING. To some extent, yes. In reply to you, Senator, a great many views have been expressed currently in the public press which would lead people to think that the people uttering those views believe that you can tax certain sources to the limit without harming or impairing the public economy. Now a tax on corporations, insofar as it is not levied on other forms of conducting business, is a tax upon the form of business and not upon business itself. A tax levied on all business profits, irrespective of the form, is of course a tax levied on business and productive enterprises. When you frame your taxes so that they are levied simply on the form on which business enterprise is conducted you run the risk, if you make that differential too great, you will simply destroy the use of that form for conducting business and your taxes will not be productive, you will have destroyed a useful piece of legal machinery under which today the majority of business is conducted.

Let me illustrate by an example: Five individuals have \$20,000 each which they desire to invest in a business enterprise. Let us suppose, even, that they expect to earn from the enterprise an annual profit as high as \$25,000, that is \$5,000 each, and that is the sole source of their incomes. Obviously individual surtaxes at present rates are not going to affect them. They would like to incorporate because the corporation is the most convenient form under which to conduct the enterprise. Its convenience is worth payment of a moderate sum in special corporation taxes. But make the tax discrimination too large and the business can be conducted as a partnership. Such special corporation taxes then produce no revenue from that enterprise. They simply bar the usefulness and convenience of the corporate form for conducting the business.

Taxes on business profits cut down either the proportion which can be distributed to the individuals who own the business, or reduce the amount which can be reinvested in the business. If the former.

the tax reduces the total amount of individual incomes subject to taxation. If the latter, one of the major sources of the growth of business capital necessary for the future increase of the total national income is impaired.

Look at the growth of American business during the past 150 years, a development which has made us the greatest industrial nation in the world, and what do we find is the major source of the business capital of the Nation? It is the reinvestment of the profits of business. Is it merely coincidence that the most severe depression we have ever experienced from which we are all too slowly emerging has occurred in a period when we have made use for the first time of business profits as a major source of taxation? Which is better for the country, the plight of the railroad corporations with their top heavy load of debt, or the automobile industry the capital of which is in large part the reinvestment of its business profits? The railroads for one reason or another have distributed almost all their net profits. They have financed their necessary growth during recent years by going more and more deeply in debt. They are today one of the Nation's major economic problems. On the other hand, we are looking to the automobile industry to lead us out of the depression. Do you think we would have the efficient low-priced car of today or that we could look to that industry as the leader in emerging from this depression if during the past 25 years the Ford Co. or the General Motors Corporation had been forced into the distribution of all their net profits as they were earned?

To sum up: If taxes are imposed simply on the corporate form of doing business, from which business conducted under other forms are free, they will not be productive of revenue, but will tend to destroy a useful form for the conduct of business. If you excessively tax all business profits irrespective of the form under which it is conducted, you tend to dry up the major source of new business capital and under the "profit-and-loss system" destroy the will to engage in business enterprise.

At present Federal taxes on corporation profits impose a tax at a flat rate subject to certain minor exceptions, and a combination capital stock and excess-profits tax. It has been proposed to substitute for the former a tax at a graduated rate, the rate increasing with the size of the individual corporation's profits. For the latter there is proposed the same form of tax but at different rates and with different exemptions. The House bill has not adopted the first proposal. It is simply an increase in the rate of the corporate income tax to 14¼ percent, a relatively small increase over the present rate. The exemption of net income not over \$15,000, by 1 percent in the tax rate is so small as to be insignificant either from the standpoint of revenue or of its economic effect. I shall, therefore, discuss first the combination capital stock and excess-profits tax.

We had an excess-profits tax for a few years following the war. It was finally abandoned and one of the reasons for giving it up was the enormous difficulty attendant upon determining the capital base upon which to compute the rate of profit. This difficulty it is now proposed to overcome by using a "declared capital" as the base.

Since it is not now proposed to go back to the use of so-called "invested capital" as the base for this tax, I shall not attempt to describe the difficulties involved. It was a "nightmare" for those of

us concerned with it and we heaved a devout sigh of relief when the tax was repealed. It is essentially an intricate accounting problem and its difficulties can be best described to you by accountants or Treasury experts who had experience with the former law. It undoubtedly resulted in unfair discrimination against those companies who not only at the time of the tax but during their entire corporate life had been least able to afford the assistance of expert accounting advice and keeping of detailed and extensive records.

Aside from the difficulty of determining a fair and, as between different corporations, equitable "capital base" an excess-profits tax is essentially unfair. Its effect is exactly the reverse of the proposed tax graduated according to the size of the profits, because it is in general the small corporation in any industry which earns the higher rate of return on its capital. Its effect is consequently to hamper and impede the growth of the small corporation. The rate of return necessary to induce investment in any enterprise depends upon the basic interest rate at any given time for investment capital plus the risk involved. An excess-profits tax therefore discriminates unfairly against those enterprises which involve the greatest risk. Remember we live under the "profit-and-loss system". The willingness to take the risk of loss must be preserved or the system will collapse.

This willingness can be only preserved by the incentive of possible profit commensurate with the risk of loss assumed. Prevent the coming and enjoyment of that profit and the willingness to risk loss withers and dies. Why is so little new capital being invested in business today? Why are the enormous excess credit facilities lying unused? Because the opportunity for their profitable investment does not appear to exist. To what extent has the threat of legislation which will hamper and curtail the ability to earn profits contributed to this stagnation? The willingness to accept the risk of loss, when the possibility of profit commensurate with the risk is present, is inherent in the character of a virile nation. It is the force which creates prosperity. Destroy the profit incentive and the force will disappear and with its disappearance this Nation will continue to stagnate in the depths of the depression until the profit incentive is restored.

An excess-profits tax further discriminates against those corporations the nature of whose business is such that their profits vary materially from year to year, some years high, other low. Take two corporations, A and B. Both have the same capital base, such that with profits of a million dollars annually no excess-profits tax is payable. During 3 years A earns a million dollars in each year. B earns two million dollars in the first year and five hundred thousand in each of the 2 subsequent years. Both have earned three million dollars in the 3 years but A has paid no excess-profits tax and B has paid such a tax in 1 year. Clearly an unjust discrimination. Of course this could be in part corrected by an averaging of profits over a period of years. But such averaging is attended with many difficulties increasing as the period for averaging is lengthened. Incidentally, if averaging is permitted it will decrease enormously the yield of an excess-profits tax.

The present proposal is to make use of a "declared capital" base to avoid the difficulties of ascertaining "invested capital." We have such a plan in the present \$1-per-thousand capital-stock tax in com-

bination with an excess-profits tax of 5 percent on the profits in excess of 12½ percent of the "declared capital" value.

How does this tax work in practice? I speak from my personal experience as one of the officers of my company forced by this law "to guess" at the right amount for the "declared capital" of my company. But I think my personal experience is typical of that of all other corporation managements under this tax. I use the term "guess" advisedly. I am not a prophet. I do not know what the profits of my company will be next year even, much less do I know or can I possibly estimate what they will be in future years. If I guess too low, my company will pay through the excess-profits tax more than would have been payable through the capital-stock tax. If I guess too high, the reverse happens. Within fairly wide limits I can estimate from past experience the probably maximum rate of profit per dollar of sales earnable in my industry. Within limits I can estimate the ratio of capital to sales necessary in my industry. By combining the two ratios I try to eliminate from my guess a small part of the element of chance. If my business or industry is one in which the profit ratio is fairly stable from year to year, I will come nearer to a correct guess, but at best the element of chance that remains is very large. This law is an enormous lottery in which the players are the Government on one side and the corporate managements on the other playing with the assets of millions of stockholders in this country. Of course, the element of chance is inherent in all business enterprise. So far as it is natural economic chance it is the essence of the "profit-and-loss system." But to artificially increase that chance on the basis of "heads" I pay you but "tails" I receive nothing, hardly seems in the public interest.

The excess profits tax paid is not going to have any relation to the rate of profits on real "invested capital". It is highly discriminatory between different companies, depending upon the relative stability of their annual profits and their luck with respect to the "guess" made by their management.

While the law forced us to make a "guess" in this "lottery", it set certain factors affecting the mathematical chances involved. These factors are (1) the rate of the capital stock tax; (2) the rate of the excess profits tax, and (3) the rate of profit on capital exempt from the excess profits tax. These three factors combined may be expressed as the ratio between the capital stock tax and the excess profits tax. That ratio in the case of the present law is six and one quarter. Vary any one of the three factors mentioned, and you change that ratio. That ratio is an important element of chance to be considered in making the guess for "declared capital". In addition thereto, however, one of the factors, namely the rate of profit, exempt from the tax must be considered also by itself as a separate element of chance. It is now proposed in the House bill to change 2 of these 3 factors, thus completely altering the chance element without giving the corporate managements the opportunity to set a new declared capital base on the new elements created. It is usually considered a violation of common decency and fair play for one of the parties to a "lottery" to change the odds on which it invited the other party to participate, and hold the second party bound to a bargain made under an entirely different set of conditions.

When I guessed at the "declared capital" for my company under the present law I made a guess as to the amount of profit which I thought it might be expected to make at least as often as once in 6 years. I then set the "declared capital" at eight times that amount. Disregarding the considerable possibility of error in the guess I made both in making the guess and in setting the "declared capital" at eight times the amount of that guess, I was basing it on the six and one-quarter ratio between the excess profits and the capital stock tax, and upon the exemption of $12\frac{1}{2}$ percent on the "declared capital."

Disregarding for the moment the higher rates in the House bill, that bill now proposes that the 5 percent rate shall be on all profits in excess of 8 percent on "declared capital." If I had considered those rates I would then have been called upon to guess not the maximum profit which I thought likely during once in 6 years, but the maximum profit which I thought was likely during once in 4 years, because the ratio between the two taxes has now become 4 to 1. This might cause me to guess the amount of profits at a slightly lower amount; how much lower would of course depend upon the variability of the profits of my company from year to year, but in stating the "declared capital" I would then have had to set it at $12\frac{1}{2}$ times the amount of profits I had guessed.

Dealing with the higher rates of tax in the House bill, you will note that in case of 10 percent tax the ratio is 12 times and profits should be multiplied $8\frac{2}{3}$ times to arrive at "declared capital". In the case of 15 percent tax the ratio is 24 times and the "declared capital" should be $6\frac{1}{4}$ times the profits. In the case of a 20-percent tax the ratio is 50 times and the "declared capital" should 4 times the profits.

One could go on multiplying examples of the working of this tax almost indefinitely. The variables and elements of chance inherent in it are so great that it is impossible to predict its effect on any one company. I think I have, however, said enough to show that it will inevitably operate in the most capricious and unfair manner between different business. I think it is certain that its effect will be most heavy and most destructive on rapidly growing businesses of small and moderate size—the very ones which, if there is to be any discrimination at all, one would expect to receive the most favorable treatment.

The CHAIRMAN. Thank you very much, Mr. Spalding. Mr. Seidman of New York City.

STATEMENT OF M. L. SEIDMAN, NEW YORK BOARD OF TRADE, NEW YORK

The CHAIRMAN. Mr. Seidman, you represent the New York Board of Trade?

Mr. SEIDMAN. Yes, sir.

On June 19, 1935, the President of the United States submitted to Congress a message on the subject of taxation. The message, quite apparently is not a fiscal document, but a statement of social and economic philosophy with regard to taxation. It is in fact a complete and unqualified endorsement of the use of taxation for nonfiscal purposes. Approval of such a measure by Congress would imply the acceptance of a philosophy of taxation having the most far-reaching implications.

In conformity with the President's message, the Ways and Means Committee of the House of Representatives has proposed a bill which would embody the following features:

1. A surtax on personal incomes in excess of \$50,000 with rates graduated up to 75 percent;
2. Inheritance taxes, in addition to existing estate taxes, graduated in rates up to 75 percent;
3. Gift taxes at rates of about three-fourths of the inheritance tax rates;
4. A tax on corporate income at $13\frac{1}{4}$ percent and $14\frac{1}{4}$ percent respectively, depending upon the size of the income; and
5. An excess-profits tax on corporate income with rates ranging from 5 percent to 20 percent, depending upon the rate of profit return and the amount of declared capital value.

These proposed taxes, it is estimated, would yield about \$275,000,000 a year of additional revenue. And since our governmental deficit last year was approximately $3\frac{1}{2}$ billions of dollars and the deficit for the current year is expected to be in the neighborhood of 4 billions of dollars, an increase in revenue of \$275,000,000 would reduce the current deficit by only about 7 percent.

Senator KING. That assumes that the present tax laws will yield as much for the coming year as they have for the past year, so the 7 percent which you said would be an increment by reason of these new taxes is based upon the supposition of a continuity of the present return?

Mr. SEIDMAN. That is correct.

The President placed special emphasis in his message, on the inheritance tax and related gift taxes, the yield from which he had specific purpose for; he said, "I strongly urge that the proceeds of this tax should be specifically segregated and applied as they accrue to the reduction of the national debt. By so doing, we shall progressively lighten the tax burden of the average taxpayer and incidentally assist in our approach to a balanced budget."

By the end of the current year, the national debt is expected to be around \$32,000,000,000. The inheritance tax and the related gift taxes are estimated to produce \$118,000,000 a year. If this were to be a means of extinguishing our debt, it would take about 275 years in which to do it, but then, since the sum represents only about $13\frac{1}{2}$ percent of the interest required to carry the debt, the insignificance of this item as a national-debt reducer is self apparent.

With regard to the philosophy of redistributing wealth, the President said, in part:

Our revenue laws have operated in many ways to the unfair advantage of the few and they have done little to prevent an unjust concentration of wealth and economic power.

A little arithmetic here also, will show that as a distribution of wealth, \$275,000,000 divided by the country's population, would yield about \$2.25 per person, not a very formidable sum with which to raise a new crop of capitalists.

Yet the bill in its various provisions follows pretty faithfully the President's proposals. It adds heavily graded inheritance taxes to the present estate taxes which in themselves stop little short of confiscation. It raises gift taxes correspondingly. It increases surtaxes on personal incomes not only in the million-dollar brackets, as

the President seemed to clearly imply, but goes down into brackets as low as \$50,000. Isn't this result, on the face of it, well nigh conclusive of the impossibility of expecting the taxation of so-called "wealth" alone to solve our fiscal difficulties?

Certainly the present proposals are a long way from meeting our budgetary requirements. Our expenditures have reached amounts far exceeding any peace-time expenditures by this or any other nation on the face of the globe. No nation, no matter how wealthy, can indefinitely go on accumulating debts and deficits without endangering its credit standing and the stability of its currency. Bringing the Budget to a balance as early as possible is imperative. The imposition of additional taxes in order to increase the income of the Government clearly can not be avoided. To the contrary, we are of the belief that any delay in adopting aggressive steps to increase taxation would accentuate our present difficulties. The New York Board of Trade is, therefore, strongly for increased taxes. It insists, however, that any new revenue legislation, if enacted, should be solely for the purpose of balancing the National Budget. And when we say balancing the Budget we mean not a dual system of bookkeeping, but limiting our total expenditures to our total revenue.

Coupled with increased taxation, we urge upon you the fundamental proposition that any program to raise additional revenue can benefit the country only if paralleled by a determination to apply the brakes to the spending of Government money.

My Board has appeared before you time and again, reiterating its belief in the income tax as the fairest sort of a tax yet devised, for governmental revenue. But time and again we have emphasized the need for a wider income tax base than has yet been attempted in this country.

As you know, an official study has recently been made of the English tax system as compared with our own. Much of good was found in the English system that should lend itself for our consideration. One of the basic principles which has made the English system of income taxation a dependable source of revenue and a certain means of keeping its budget balanced in good times and in bad, has been the broad basis upon which its income tax is imposed. Tax exemptions are substantially below our own and the tax-rate structure is generally two or three times our own.

From a married individual with no other dependents having a net income of \$2,500 we collect no tax at all. In Great Britain such a person pays into the treasury what is equivalent to \$182.81. There such a married man with an income as low as \$800 pays something as his direct share to defray Government expenses. Only when incomes reach as high as \$1,000,000 do our tax rates begin to equal those of England. Their principle is to collect as much as possible from the greatest number of people. Ours has tended toward large exemptions, and extremely small rates on the lower income brackets, offset only in small degree by excessive rates on the highest incomes. About the same disproportionate relationship exists between the British death taxes and our own.

Experience has demonstrated that the excessive taxation of large incomes and estates will not only not produce revenue, but will, in addition, dry up the source of revenue.

In fixing the point of maximum return from taxation, there are practical considerations which must be taken into account. True, no one can accurately measure the exact point at which ability to pay increases as income or the size of an estate increases, but the practical effects of excessive tax rates are not difficult to determine. Thus, in the case of large estates where the Government at the present time takes from 50 percent to 60 percent in the form of estate taxes, the present existing tax rates would appear to be about as high as can be justified on any ground. Death taxes are imposed upon the basis of values at the time of death. No possible method exists by which the contingency of a sudden change in values can be guarded against. Assuming it is not the intention of the Government to compel the owner of property to convert it into cash prior to his death as a protection against the possibility of the tax liability absorbing his entire estate, then some margin must be left, above the amount of tax, for administration expenses, and the possible shrinkage in the market value of the property of the estate during the period of administration.

As to materially increasing the tax on the largest income group, it would appear that there as well we cannot, under the present law, be very far from the point of diminishing returns. The present maximum rate is 63 percent, and if State income taxes are to be added as they should, in considering ability to pay, then the total approaches complete confiscation of income.

The idea of an enforced leveling down of large fortunes to increase small incomes is not a new one by any means. It has been advocated for a long time as a means of making everybody rich, but practical obstacles have been recognized and common sense has prevailed. Such a policy is based on the assumption that no one derives any benefit from wealth unless he owns it. Quite to the contrary, isn't it by this time well recognized that the humblest wage earner is benefited by every improvement in commerce and industry? Would it not seem that the public interest is not so much in the ownership of capital as in the service which capital renders? Would it not appear that through taxation or otherwise, any policy that seeks a larger share for some at the expense of others will accomplish no more than reduce the aggregate wealth, and with it everybody's share?

Because of these facts, the New York Board of Trade recommends a courageous broadening of the tax base as one of the most effective means of bringing our Government finances into ultimate balance, and at the same time making our citizens recognize their own personal interest in the expenditures of their Government.

The New York Board of Trade stands for taxation, which, expressed in the President's own words, should be "based on the broad principle that if a Government is to be prudent, its taxes must produce ample revenues without discouraging enterprise, and if it is to be just, it must distribute the burden of tax equitably." No government, it would seem, can be considered prudent if it attempts to collect taxes on such a basis as would tend to discourage enterprise. Encouraging enterprise, particularly in the present state of industrial convalescence, would certainly appear to be much more important than almost any other consideration. Who is there who can doubt that the imposition of a tax engulfing beyond a certain point almost the entire income would discourage enterprise? Who is there who can doubt that taking the

major part of an estate first and then again taking the major part of what is left would similarly discourage enterprise?

May I call your attention to section 702, title 1, of the proposed bill with regard to the imposition of the so-called "excess-profits tax" on corporate income? If this provision should be enacted in its present form, the result would be the perpetration of an extreme injustice upon the taxpayer, particularly on the small corporation.

To understand my point, it is necessary to consider for a moment the status of taxpayers under the present capital-stock and excess-profits tax law. On June 16, 1933, and in connection with the National Industrial Recovery Act, there was imposed a capital-stock tax on substantially all corporations. This tax was calculated on the basis of \$1 for each \$1,000 of declared value of a corporation's capital stock. The law now in force is a continuation of the one enacted in June 1933, the latter, by its terms, having only a limited life.

Some years ago we also imposed a Federal capital-stock tax upon corporations. The tax then, however, was imposed annually upon the actual value of a corporation's outstanding stock. This led to much controversy over the element of value, since actual value had to be supplied every year. Congress, in enacting its capital stock tax law in 1933, and again in 1934, struck upon an ingenious scheme for avoiding controversy over value. It permitted a corporation to declare any value it might choose, and pay \$1 on every \$1,000 of such an amount declared. However, in order to collect the maximum amount of tax from this source, it was provided that, should the net corporate income be greater than 12½ percent of the amount declared, then any such excess was to be subject to a 5 percent excess-profits tax.

In effect, Congress said to the corporation, "You declare an amount upon which you are willing to pay \$1 a thousand. For every \$1,000 so declared you will be allowed to earn \$125 free of excess-profits tax. However, should you earn more than \$125 for each \$1,000 so declared, you will pay \$6.25 instead of \$1 for every \$1,000 by which your declared value is short." The arrangement was a pure gambling proposition. The taxpayer was called upon to estimate in advance his possible earnings and then to weigh the desirability of paying \$1 per \$1,000 of declared value in order to avoid the possibility of having to pay six and one-fourth times \$1, should he have earnings greater than estimated. After first guessing at his possible earnings, he could arrive at the amount to be declared only if he took into consideration (a) the exemption, namely, \$125 per \$1,000 of value declared, and (b) the rate of excess-profits tax, namely, 5 percent. If, after taking these factors into consideration, the taxpayer made a wrong guess as to his possible income, he paid a penalty of 6¼ to 1.

Had these two factors in any way been changed, then the taxpayer would have necessarily changed the amount of value declared. The law itself and everything in connection with its enactment, made it perfectly clear that the arrangement is as I here outline it.

The plan, while ingenious in its conception, is obviously wrong in principle. For any scheme of taxation which permits two taxpayers equally situated to pay a different amount of tax on exactly the same amount of income is certainly wrongly conceived. At any rate, a guessing contest it has been and the corporation most poorly equipped to do accurate guessing has been the one to be hardest hit.

The present proposal is to hold the taxpayer to the declared value made under the earlier act, but, at the same time, to reduce the exemption and to increase and accelerate the rate of tax. Hereafter he must pay the penal rate on income exceeding \$80 per \$1,000 of declared value instead of \$125 as heretofore. In addition, if his guess as to possible income was far enough out of line, he would now be called upon to pay a penalty of not $6\frac{1}{4}$ to 1, but as much as 25 to 1. Obviously, if any such guessing contest is to be made a part of our permanent revenue laws, then would it not seem only fair and just, in the light of the facts here set forth, that the taxpayer be given the right to declare a new amount as a basis for taxation, every time a change is made either in the exemptions or the tax rates, or both, as the proposed law attempts to do?

If sportsmanship is to enter into the basis of calculating a tax, then is it good sportsmanship to have the taxpayer rely upon the solidity of certain props built up for him by the Government to assist him in determining the amount of the tax, and then for the same Government to actually pull those props from under him to his complete bewilderment and dismay? This is exactly what the enactment of the law in its present form would amount to.

I believe that guesswork, such as is involved in the present scheme of capital stock and excess-profits taxation, has no place in our tax system, but if this sort of thing is to continue, then it would certainly appear to be only elementary justice that the taxpayer be given an opportunity to declare under the changed law the amount upon which he chooses to pay \$1 per \$1,000 in order to avoid having to pay as much as \$25 per \$1,000 if his guess as to income should prove to be wrong.

As to a progressive rate schedule to be substituted for the present flat rate in taxing corporate income, this is a new and radical departure in Federal income-tax legislation. While the proposed differential is now very small as compared to the differential recommended by the President, the principle involved is wrong. The objective is essentially nonfiscal. The purpose is not to reach profitability, but size. Yet no data have been offered to show that large corporations generally earn a larger profit than do the smaller corporations in proportion to capital employed. To argue against bigness is clearly a fallacy. Why are some businesses large and others small? Is large-scale enterprise undesirable? That is equivalent to saying that our industrial progress in the last 25 years is devoid of meaning. The development of large units in the motor-vehicle industry, for instance, has occurred solely during that period. Large-scale production has been accompanied by substantial reductions in price despite constant improvement in product. Instead of imposing a tax on bigness as such, we recommend that there be no differential on that score but that instead every corporation having an income of less than \$25,000 be given a \$2,000 income exemption, then increase the present 13 $\frac{1}{4}$ percent tax rate to 14 $\frac{1}{2}$ percent or even 15 percent on all corporations.

On several previous occasions my board has appeared before you recommending the enactment of a general sales tax to supplement the income tax. Since our last appearance before you, there have been enacted various processing taxes. These, we consider, are sugar-coated sales taxes in the worst form. They tax the food, the clothing, and the shelter of the poor to an extent undreamed of by

any advocate of the sales tax. In fact, they tax the very necessities of life which we deliberately urged for tax exemption. They exist only because the consumer is not made aware of the part such taxes play in his cost of living.

We are for a man paying his tax knowingly. We are convinced that the chief cause of indifference on the part of so many people toward this entire problem of taxation and expenditures is lodged in the very fact that the average man does not realize he is paying his share of the cost of running the Government. He is therefore all for spending what he thinks is the other fellow's money.

Senator CONNALLY. Do you advocate the sales tax? You have heretofore advocated the sales tax?

Mr. SEIDMAN. We have.

Senator CONNALLY. You are against the processing tax?

Mr. SEIDMAN. We believe a processing tax is nothing more than a sales tax in disguised form.

Senator CONNALLY. But you are for the sales tax and you are against the processing tax because it is a sales tax?

Mr. SEIDMAN. We are against the processing tax for two reasons. First, that it imposes a high sales tax upon the very products which should be exempt from tax, such as food, clothing, and shelter. And, second, that it is a sales tax in disguised form, so that the consumer does not know he is paying it. We are for the consumer knowing the taxes he is paying.

May I, in conclusion, again emphasize the urgent need for the broadening of our tax base. In no other way can we hope to ultimately bring our finances into a normal balance. I have prepared a schedule of what might be done along the lines of broadening the income-tax base. Under it, while the normal tax, credit for dependents, and the exemption for a single individual would remain the same as under the present law, the exemption for a married person would be reduced from \$2,500 to \$1,500, and the surtax would apply at a 10-percent rate to incomes of \$4,000 in excess of exemptions and credits. The rates would then increase up to as high as 75 percent on incomes above \$1,000,000.

Under the proposed bill the 75 percent maximum rate is reached at the point of a \$5,000,000 income. In my schedule the 75 percent maximum rate is reached at the point of a \$1,000,000 income. A 75 percent income-tax rate plus a State income tax will in many cases amount to virtual confiscation of income. Yet my board is aware that as a matter of practical politics, Congress cannot be asked to tax smaller incomes more heavily without at the same time being asked to substantially increase rates all along the line.

As to inheritance taxes generally, it would seem preferable that any additional revenue sought to be collected from death taxes should come about through an increase of the present estate tax rates for the most part in the lower brackets if revenue is what we are after. The imposition of a new and extremely complicated inheritance tax would seem unnecessary as a fiscal measure. However, if separate inheritance taxes are to be imposed in addition to the present estate taxes, I suggest a small exemption, possibly \$10,000 and tax rates ranging from 1 percent on the first \$90,000 above exemption to a maximum of 10 percent on inheritances above \$900,000. This is approximately the range of similar taxes imposed in England after long experience with the subject.

(The tables presented by Mr. Seidman are as follows:)

Supplemental data on tax rates

Amount of surtax, net income	Surtax				Normal tax	
	Rate, percent		Total surtax		4 percent normal tax	Total tax
	1934 act	Proposed	1934 act	Proposed		
\$0 to \$4,000.....					\$0	\$1,000
\$4,000 to \$6,000.....	4	10	\$80	\$200	4,000	6,000
\$6,000 to \$8,000.....	5	11	180	420	6,000	8,000
\$8,000 to \$10,000.....	6	12	300	660	8,000	10,000
\$10,000 to \$12,000.....	7	13	440	920	10,000	12,000
\$12,000 to \$14,000.....	8	14	600	1,200	12,000	14,000
\$14,000 to \$16,000.....	9	15	780	1,500	14,000	16,000
\$16,000 to \$18,000.....	11	17	1,000	1,840	16,000	18,000
\$18,000 to \$20,000.....	13	19	1,260	2,220	18,000	20,000
\$20,000 to \$22,000.....	15	21	1,560	2,640	20,000	22,000
\$22,000 to \$26,000.....	17	23	2,240	3,560	22,000	26,000
\$26,000 to \$32,000.....	19	25	3,380	5,060	26,000	32,000
\$32,000 to \$38,000.....	21	27	4,640	6,680	32,000	38,000
\$38,000 to \$44,000.....	24	30	6,080	8,480	38,000	44,000
\$44,000 to \$50,000.....	27	33	7,700	10,460	44,000	50,000
\$50,000 to \$56,000.....	30	38	9,500	12,740	50,000	56,000
\$56,000 to \$62,000.....	33	41	11,480	15,200	56,000	62,000
\$62,000 to \$68,000.....	36	44	13,640	17,840	62,000	68,000
\$68,000 to \$74,000.....	39	47	15,980	20,660	68,000	74,000
\$74,000 to \$80,000.....	42	50	18,500	23,660	74,000	80,000
\$80,000 to \$90,000.....	45	53	23,000	28,960	80,000	90,000
\$90,000 to \$100,000.....	50	58	28,000	34,760	90,000	100,000
\$100,000 to \$150,000.....	52	62	54,000	65,760	100,000	150,000
\$150,000 to \$200,000.....	53	64	80,500	97,760	150,000	200,000
\$200,000 to \$300,000.....	54	66	134,500	163,760	200,000	300,000
\$300,000 to \$400,000.....	55	68	189,500	231,760	300,000	400,000
\$400,000 to \$500,000.....	56	70	245,500	301,760	400,000	500,000
\$500,000 to \$750,000.....	57	72	388,000	481,760	500,000	750,000
\$750,000 to \$1,000,000.....	58	74	533,000	666,760	750,000	1,000,000
\$1,000,000 and up.....	59	75			¹ 1,000,000	

¹ And up.

Normal tax.—This tax would remain at 4 percent as under the 1934 Revenue Act.

Personal exemptions.—The exemption for a married individual would be reduced to \$1,500 in lieu of the \$2,500 exemption under the 1934 Revenue Act. The exemption for a single person as well as credits for dependents would remain the same.

Inheritance tax.—

Amount of inheritance:	Rate (percent)
\$1 to \$10,000.....	None
\$10,000 to \$100,000.....	1
\$100,000 to \$200,000.....	2
\$200,000 to \$300,000.....	3
\$300,000 to \$400,000.....	4
\$400,000 to \$500,000.....	5
\$500,000 to \$600,000.....	6
\$600,000 to \$700,000.....	7
\$700,000 to \$800,000.....	8
\$800,000 to \$900,000.....	9
\$900,000 to \$1,000,000 and over.....	10

Senator LONERGAN. Mr. Seidman, you represent the New York Board of Trade?

Mr. SEIDMAN. Yes, sir.

Senator LONERGAN. Will you please tell us the personnel of the New York Board of Trade? Are all business represented?

Mr. SEIDMAN. The New York Board of Trade is represented by almost every sort of business imaginable. It has manufacturers, commercial houses, banks, professional men, and so forth. It is

thoroughly representative of the commercial and industrial activity of the city of New York and State of New York.

Senator LONERGAN. What is your official capacity?

Mr. SEIDMAN. I am a member of its board of directors, a member of its executive committee, and a member of its tax committee.

Senator LONERGAN. You are a tax expert?

Mr. SEIDMAN. I am a certified public accountant.

Senator LONERGAN. Have you filed with the committee the taxes that are paid by the residents of New York in New York State?

Mr. SEIDMAN. I haven't filed it with the committee.

Senator LONERGAN. I wish you would.

Mr. SEIDMAN. I believe what New York residents pay is a matter of record in your documentary evidence here as to the State income taxes, the State inheritance taxes, the local personal property taxes, and all that, that is all a matter of record, I am quite sure.

Senator LONERGAN. Have you any ideas as to the economies that ought to be introduced in the Federal Government to save expenses?

Mr. SEIDMAN. Of course it would be utterly foolish for me to come up here and tell you gentlemen where to start and what to do to economize.

Senator LONERGAN. If you have any views, I think we would be glad to get the benefit of them.

Mr. SEIDMAN. We do know this, we do know we are spending today more than \$2 for every \$1 we are taking in. We know that cannot last forever. We say that you are better experts than we are as to where to begin to cut, but cut you must, expenditures must be cut. It is quite evident you cannot raise the revenue even under the schedule I propose. It would only be a drop in the bucket to raise the revenues to meet our expenditures, but at least we might make a definite step in that direction. I think that would be most encouraging to the business men of this country, and to the citizens generally.

Senator LONERGAN. Now, as I understood you, you maintain that some of these proposals represent capital levies; is that correct?

Mr. SEIDMAN. I maintain that they, in effect, confiscate the income and capital.

Senator LONERGAN. If that be true, that would be destructive of business.

Mr. SEIDMAN. I believe it is, and I believe I have said so.

Senator LONERGAN. Thank you, sir.

Mr. Powell, Henry M. Powell.

STATEMENT OF HENRY M. POWELL, NEW YORK, N. Y., REPRESENTING NEW YORK ASSOCIATED INDUSTRIES

The CHAIRMAN. Mr. Powell, you represent the New York Associated Industries?

Mr. POWELL. Yes, sir.

The CHAIRMAN. All right, you may proceed.

Mr. POWELL. I represent the Associated Industries of the State of New York, and I am a member of its tax committee. I want to tell you something about our association so that you may understand how we are affected by the taxes that I am going to refer to.

That association was incorporated in New York in 1914 to protect industrial organizations, manufacturers, and merchants from unreason-

able and unnecessary legislation, and to cooperate with the legislature in well-considered labor laws and business generally.

To give you an idea of the extent of our association, I will say that while it was incorporated originally with 39 manufacturers and corporations, it now represents some 2,500 manufacturers and merchants organized or doing business in New York and the members of the association now give employment to nearly 600,000 men and women out of an approximate aggregate of 1,300,000 wage earners of the State of New York, and the members of that association represent an invested capital of about \$2,500,000,000.

The State of New York every year imposes taxes on about 150,000 corporations, not all on income, however. You will therefore see, when you compare the importance of the corporation tax of the United States with that of the State of New York, that we have about 30 percent, or 33½ percent of the corporations of the entire Union who are either doing business in the State or are organized under our law.

Senator GERRY. What is the name of the business corporation that you represent?

Mr. POWELL. The Associated Industries of the State of New York.

Senator KING. With a 2,500 membership?

Mr. POWELL. We have 2,500 members. Nearly all of the great manufacturing and mercantile corporations in the State of New York are members of that association.

This association opposes the bill before your committee, and we particularly object to the graduated corporation tax and to certain features of the excess-profits tax.

The graduated corporation tax discriminates against the stable well-managed large corporation.

Of approximately 450,000 corporations that made Federal income tax returns in 1932 about 370,000 showed no net income at all. Only 82,646 corporations showed any net income, and of these a little over 9,000 showed income of more than \$15,000, and of this latter number only 2,107 corporations produced net incomes of more than \$100,000. Thus it appears that only one-half of 1 percent of all the corporations making returns in 1932 produced incomes of \$100,000 or more and only a little more than 2 percent of the corporations making returns showed income of \$15,000 or more.

Senator KING. Most of the corporations, then, were under \$15,000?

Mr. POWELL. Yes.

Senator KING. That would be 98 percent under?

Mr. POWELL. About 11 percent come under this classification that are going to pay the graduated corporation tax.

Senator CONNALLY. What are the figures as to the volume of income?

Mr. POWELL. They were published in 1932. I think there were about \$400,000,000 of income in round numbers. That is, the tax was \$400,000,000. I cannot say offhand without wasting time.

Senator KING. You will find that, Senator, in the House Reports, pages 6 and 7.

Mr. POWELL. In its incidence the tax will fall upon the stockholder rather than upon the corporation. Many of these income-earning corporations have thousands of stockholders, and I believe the American Telephone & Telegraph Co. has something like 600,000, or nearly 700,000 stockholders.

Senator CONNALLY. Does it belong to your association?

Mr. POWELL. I do not know whether they are members of our association. We specialize in the manufacturing and mercantile corporations.

Senator CONNALLY. All right.

Mr. POWELL. Many of these income-earning corporations have thousands of stockholders, some of them hundreds of thousands of stockholders with average holdings of 100 shares or less. If President Roosevelt seeks to secure a better distribution of wealth by this bill, the contrary result will be produced. By striking at the stockholder through the corporation, it will discourage investments in corporate industry and lead to greater unemployment.

This association opposes certain features of the excess-profits tax and particularly it opposes the tax on excess profits in the lower brackets. Some of the speakers that preceded me have called attention, in figures, to what would happen. We all made our returns. My clients, your clients, and corporations generally made their returns on the basis of the prospective 12½ percent tax.

I want to say, as other speakers have said, that corporations have their lean years and they have their good years and losses in the lean years are counterbalanced by profits in good years. Prudent and well-managed corporations set aside in good years reserves for future losses and other contingencies. With an excess-profits tax beginning at 8 percent penalty is imposed upon prudent management.

Senator CONNALLY. What is that?

Mr. POWELL. I say with an excess-profit tax beginning at 8 percent you penalize the corporation.

Senator CLARK. The same thing is true of individuals, in regard to surtaxes on income taxes. A man may have a good year and accumulate a surplus, and then have a bad year and then apply the accumulated surplus in surtaxes on income. The same principle applies.

Mr. POWELL. The important thing is, the high courts in this country have held in rate cases where corporations held valuable franchises that 8 or 9 percent was not an unfair return upon capital investment in business. In fixing the lower limit of 8 percent subject to excess-profits tax, the bill penalizes business and prevents it from borrowing money at prevailing rates of interest with the opportunity of repaying it.

Senator CONNALLY. That is not an answer to the Senator from Missouri. What is the difference between paying surtaxes on individual incomes after they have made a certain percentage and paying excess-profits taxes on corporations after they are allowed an exemption of a certain percentage return on their capital? What is the difference?

Mr. POWELL. The individual is not taxed upon his business, he is taxed upon his income.

Senator CONNALLY. He is taxed on the income that he makes.

Mr. POWELL. The excess-profits tax is a business tax essentially.

Senator CONNALLY. How does the man get his income except out of business? It is based on profits. If he does not make it he does not pay it, and if he does make it he ought to pay it.

Mr. POWELL. Every individual is not engaged in business.

Senator CLARK. As I understand it, the point you are making was, if a corporation was caught with a high tax in a good year he would

not be able to recoup in a bad year. Exactly the same principle applies to private individuals with individual incomes, as far as the surtax is concerned; isn't that true? An individual may make a big income in one year, he happens to have a good year, and makes a big income, and he gets caught with a heavy surtax, and the next year he has a bad year, and he is not going to be able to go back and offset the fact that he paid the heavy income tax and surtax the year before. That is precisely the point I make in the case of a corporation.

Senator GUFFEY. Isn't this true, Mr. Powell, in the case of an employer who has an organization of 500, or 1,000, or 2,000 or 3,000 employees, that with this reserve he is able to carry on, and that that does not apply to the individual?

Mr. POWELL. That is it exactly. Every individual is not engaged in business, but corporations are engaged in business, and I am here representing business and manufacturing corporations.

Senator KING. Moreover, the earnings of corporations are not held by a few individuals; they are distributed, as you mentioned, where one corporation had more than 600,000 stockholders. Now the imposition of a very heavy graduated tax upon incomes of corporations penalizes—I use the word “penalize” in the sense of exacting the tax from them—a large number of perhaps millions throughout the United States who are stockholders in corporations, and their incomes are rather small, and it takes from them taxes which perhaps they would not pay because of their limited income, which is supplemented by the dividends which they get from these corporations. Therefore, the imposition of the excess-profits tax is taxing large numbers, millions of small stockholders, in the largest number of corporations.

Mr. POWELL. That is quite true. In fact, I read in a report here recently that a very large percentage of the stockholders in many of these corporations consist of women.

Senator KING. Some estates, too.

Mr. POWELL. And estates.

Senator KING. The savings of prudent men who left a little to families, and they have got in corporations, and those families would be penalized in the sense they would be subjected to the heavy excess-profits tax levied on the corporations in which they might have a very small stock.

Mr. POWELL. In that connection, an application was made recently to one of our surrogates in New York to permit the trust estate to invest some of the funds in common stock, but of course the surrogate was obliged to refuse it. They look upon the common stock as investments that they may withhold income from.

I have another objection to the excess-profits tax, that has already been referred to by the speakers who preceded me, that is to the adjusted invested capital for the preceding year as being an arbitrary, unfair method of taxing the valuation of capital stock. That should be amended. That was done on a guess, as some of the speakers have referred to. They thought they would be taxed on their excess profits some 12½ percent.

Mr. Seidman, who preceded me, worked out in figures how this would affect corporations that come under the amended law. The original declared value is not elastic.

The CHAIRMAN. If they permitted them to declare a new value on the capital stock, they would rather have that done, even though you should increase the capital stock levy a little bit; isn't that true?

Mr. POWELL. Yes, that was the feeling on that question.

The CHAIRMAN. The capital stock levy now is very small. Even if it could be increased a little bit, to recoup whatever loss there was on the other, they would rather have that?

Mr. POWELL. The small capital stock tax that was imposed made corporations feel that they would rather look ahead and feel that they are going to make profits in future years, and give a larger valuation to their capital. It is not a very scientific or accurate method.

The CHAIRMAN. But you have no doubt that industry feels that way exactly, they would not object to an increase in the capital stock tax provided they had a right to make a new valuation of their capital stock invested?

Mr. POWELL. I think it could be worked out on a little more elastic basis.

The basis for computing the excess profits tax on the adjusted invested capital as declared for the preceding year is an arbitrary and unfair method of fixing the valuation of capital stock and should be amended.

Another general objection to the entire excess-profits tax is that it should only be used as an emergency tax for a war tax. It has no other economic classification.

The CHAIRMAN. Thank you. Mr. T. J. Priestley, Jr., of Philadelphia.

STATEMENT OF T. J. PRIESTLEY, JR., OF PHILADELPHIA, PA., PRESIDENT THE PRIESTLEY PRINTERS

The CHAIRMAN. You are president of the Priestley Printers?

Mr. PRIESTLEY. Yes, sir. Mr. Chairman, I have been thinking for more than 5 years about a tax which is very similar to our President's tax which he sent to Congress on June 19, but my tax has for its objective the reemployment of our unemployed in their regular jobs, rather than making alone the Budget. I believe if that tax could be worked, it would be very much better than the tax that the President proposes, which I do not think will bring in the amount that is expected to pay the Budget.

The President's idea is just about 100 percent perfect, but his plan of putting it into effect is not right. If I may read a few of the paragraphs from that message of the President I will show you what I mean.

The CHAIRMAN. I think the committee is very familiar with the President's message. Just give us your plan.

Mr. PRIESTLEY. My idea is a step-rate sales tax, a tax put on the total amount of sales rather than the net profits that a corporation may make. If that is done, why, it would distribute the employment around. In other words, my tax is first of all, to meet the Budget; next, it will place all of the unemployed in employment; and next it will encourage very many more enterprises than it may discourage, and it will make for general prosperity.

The CHAIRMAN. Are you speaking now of the general manufacturers' sales tax?

Mr. PRIESTLEY. No, I am speaking of a step-rate sales tax.

The CHAIRMAN. Explain what you mean by a step-rate sales tax.

Mr. PRIESTLEY. A step-rate sales tax is that tax which would be placed on any line of business, by allowing any manufacturer, any farmer, any merchant, to produce a fair amount of business in his line without any tax whatsoever. That tax could be found by taking the total amount of business that is done in each line of business, and dividing it by those that are in that business. Each, then, would be allowed to do a certain amount of business, or a fair amount of business in that line, without any taxation whatsoever. If those that are in that line should produce twice as much, then they would pay 1 percent for the additional fair amount of business in that line, 2 percent for the third amount of business in that line, and so on.

I am a printer and it would affect me something like this: In 1934, that is last year, the printers could have done \$56,000, which would have made the total amount of all the printing that was done. If a printer did \$56,000 he would pay no tax whatsoever, but if he did \$112,000 he would pay a tax of \$560, which is 1 percent on the additional fair amount of business in that line. If he did up to a million dollars worth of business he would pay, on that same step-rate plan, only 8½ percent, but the last 56 thousand to reach that \$1,000,000 worth of business would cost him \$9,520, or 17 percent for the privilege of doing that last \$56,000 worth of business.

In other words, the thought is to bring down business in the higher brackets and distribute it to the smaller concern, so that all can be employed. Now for every man that is employed in a large concern there are about four out of jobs in small industries, and that is our trouble today. Technocracy has grown so that by machination they can dispose of so many men. Any lot of men can get together, with wonderful finances, and go into most any kind of business, with this increased producing machinery, and eliminate practically everybody in that line, if they have enough money and spend enough to do that.

It is that thought that I have in mind, which is in the mind of the President. His idea is just 100 percent perfect, but it is not going to do the trick in the way of placing it on incomes. Total sales is the proposition.

The CHAIRMAN. As to the volume of business, where would you start from? We have got to take the aggregate.

Mr. PRIESTLEY. In other words, if a small business is allowed to exist there will be business enough for the large ones too. In other words, our trouble is that the small business man has been put out of business, consequently the man who employs others would have been put out of business. If there is no purchasing power it does not matter what a tax would bring forth, it will not bring us out of the hole that we are in.

All of the taxes to be brought forth by this new process would not help us out of our dilemma. In other words, if we take the statistics of manufacturers in 1925—and these are Government statistics—we find that the manufacturers numbered 187,000, and they did a certain amount of business, they employed a certain number, and each of their employees, that is those that were in class 1, as I have it here, doing less than \$20,000, each man produced \$4,018. In the class of manufacturers that did between \$20,000 and \$120,000 the

averaged production per man was \$4,955. In class 3, those who did between \$100,000 and \$500,000, each of their men produced \$5,714. In the fourth class, between \$500,000 and \$1,000,000, each of their men produced \$6,072. In class 5, those that did over \$1,000,000, the 10,000 manufacturers did 42 percent of all the manufacturing that was done in 1925, and their men produced \$8,900.

Now if one man in a large concern can produce \$8,900 worth of products and a man in a smaller concern can only produce \$4,000, it does look to me that some system of taxation which would equalize that should go into effect, because if one man in a small concern can only produce \$4,000 and a man in a large concern can produce \$9,000, it is only a short time before all the small concerns will go by the board, unless some taxation is made to equalize that.

That is my thought, and my thought is, as I say, just exactly the same as our President's thought. It is perfect.

The CHAIRMAN. If you desire to elaborate that you may put your plan in the record.

(The following matter was submitted by Mr. Priestley in extenuation of his remarks:)

PRESIDENT ROOSEVELT'S TAX MESSAGE, JUNE 19, 1935, TOGETHER WITH THE STEP-RATE SALES TAX (BY T. J. PRIESTLY, JR.) FOR THE ECONOMIC CONTROL OF INDUSTRY AND FOR THE REEMPLOYMENT OF WORKERS

THE WHITE HOUSE.
Washington, July 12, 1933.

T. J. PRIESTLY, Jr., Esq.
321 S. Juniper Street, Philadelphia, Pa.

MY DEAR MR. PRIESTLY: The President has received your letter of July 8 with the enclosed tract, and appreciates your courtesy in letting him have the benefit of your suggestions. By his direction your communication is being referred for the consideration of the Special Board for Industrial Recovery, of which the Secretary of Commerce is chairman.

Very sincerely yours,

LOUIS McH. HOWE,
Secretary to the President.

T. J. PRIESTLY, Jr.,
Philadelphia, Pa.

TREASURY DEPARTMENT,
Washington, December 29, 1933.

DEAR SIR: I have received your letter of December 21, 1933, and its enclosures with respect to the imposition of a step-rate sales tax.

The Treasury Department is making a careful study of revision of the Federal tax laws and is very glad to have the benefit of your suggestion.

Very truly yours,

ROSEWELL MAGILL,
Assistant to the Secretary.

PARAGRAPHS FROM THE TEXT OF PRESIDENT ROOSEVELT'S TAX MESSAGE,
JUNE 19, 1935

To the Congress of the United States:

As the fiscal year draws to its close it becomes our duty to consider the broad question of tax methods and policies. I wish to acknowledge the timely efforts of the Congress to lay the basis through its committees for administrative improvements, by careful study of the revenue systems of our own and of other countries. These studies have made it very clear that we need to simplify and clarify our revenue laws.

The joint legislative committee, established by the Revenue Act of 1926, has been particularly helpful to the Treasury Department. The members of that committee have generously consulted with administrative officials, not only on broad questions of policy, but on important and difficult tax cases.

On the basis of these studies and of other studies conducted by officials of the Treasury, I am able to make a number of suggestions of important changes in our policy of taxation.

These are based on the broad principle that if a Government is to be prudent, its taxes must produce ample revenues without discouraging enterprise, and if it is to be just, it must distribute the burden of taxes equitably.

I do not believe that our present system of taxation completely meets this test. Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power.

With the enactment of the income tax law of 1913, the Federal Government began to apply effectively the widely accepted principle that taxes should be levied in proportion to ability to pay and in proportion to the benefits received. Income was wisely chosen as the measure of benefits and ability to pay. This was and still is a wholesome guide for national policy.

Furthermore, the drain of a depression upon the reserves of business puts a disproportionate strain upon the modestly capitalized small enterprise. Without such small enterprises, our competitive economic society would cease. Size begets monopoly.

Moreover, in the aggregate these little businesses furnish the indispensable local basis for those Nation-wide markets which alone can insure the success of our mass-production industries. Today our smaller corporations are fighting not only for their own local well-being but for that fairly distributed national prosperity which makes large-scale enterprises possible.

It seems only equitable, therefore, to adjust our tax system in accordance with economic capacity, advantage, and fact. The smaller corporations should not carry burdens beyond their powers; the vast concentrations of capital should be ready to carry burdens commensurate with their powers and their advantages.

We have established the principle of graduated taxation in respect to personal incomes, gifts, and estates. We should apply the same principle to corporations. Today the smallest corporation pays the same rate on its net profits as the corporation which is a thousand times its size.

In addition to these three specific recommendations of changes in our national tax policies, I commend to your study and consideration a number of others.

THE "STEP-RATE" SALES TAX FOR THE ECONOMIC CONTROL OF INDUSTRY

(By T. J. Priestley, Jr.)

The word "tax" seems so repulsive that we endeavor to shun the person who mentions it. If he mentions a sales tax, we are likely to call him a fool or otherwise make some insulting remark, and indeed a general sales tax is a most vicious tax, inasmuch as it passes to those less able to pay, and makes a burden too heavy to bear when unemployment is most general. But there is nothing surer than the fact that we are going to be more heavily taxed.

Every charitable undertaking that is now being fostered by the Government to reduce unemployment distress must be paid for.

Now that we are going to be further taxed, is it not better to face it and see if there is not some way to sustain the Government and at the same time benefit all of the people?

There is a law which permits a fisherman to catch just a certain number of fish in our inland waters. Good sportsmen like and obey this rule, which has been made to allow each fisherman an equal opportunity. Those who fail to obey this law are forced to pay a fine.

A step-rate sales tax would stop each of us from everlastingly trying to monopolize, and the welfare of the Nation would be greatly enhanced.

Should not human happiness be considered more important than commercial or financial supremacy of a few?

Every time we think of the depression, we believe it was caused by over-production and the use of labor-saving machinery, and we let it go at that. We are right in our deduction but we fail to go to the root of the evil.

There has not been, nor ever will be, over-production in the sense that at any time all the people had all the things they desired. Monopolistic over-production by the few has caused under-production by the many, therefore, under consumption by the many has been caused by lack of production as a medium of exchange of the many.

Whether it be banking, farming, manufacturing, merchandising, or just ordinary laboring, too much is produced by the few and too little by the many. If, therefore, more is produced by the many and less by the few, employment will follow and the purchasing power of the many as well as the few will be the logical sequence.

Man's needs today are many times greater than they were in 1900, and if monopolies had not hogged the production of the new and old needs, all would have been profitably employed.

Today we are making tremendous strides in producing labor-saving machinery. Large corporations are scrapping their old machiens and replacing them with modern equipment in order to lessen the need of human help. This is perfectly right. Civilization must advance.

Financial magnates are forming holding companies in order to eliminate duplication and enhance quantity production. This, too, is right. We must cut out waste in order that all may enjoy the products of our plants and factories to the fullest extent.

But 3 percent of our plants, factories, financiers and agricultural corporations should not be allowed to kill the 97 percent of the smaller manufacturers, farmers, etc., by virtue of their labor-saving machinery and their strongly entrenched finances.

It has taken a very few agricultural corporations, wheat-growing corporations, hog, sheep, and beef-raising corporations, etc., which are backed by the Wall Street financial octopus, to depress the farmer. If our Government had not taxed the consumer through a processing tax to sustain the farmers as well as the corporations (which received the most benefit by virtue of having larger acreage) the catastrophe would have been more appalling.

How can a farmer with 150 acres economically compete with the wheat-growers corporations, having 137,000 acres in wheat, planted and harvested by the most up-to-date labor-saving machinery?

How can the manufacturer selling \$5,000 worth of his product a month economically compete with the manufacturer of the same product selling \$100,000 a month.

No one in his right mind in this country would think of hindering the initiative of our citizens, but our Government has rightfully seen fit to put an increased step-rate income tax on individual incomes even to the extent of taking \$600,000 out of incomes of \$1,000,000.

LIVE AN LET LIVE

Would it not be proper to reduce somewhat the income tax, and make a "step-rate sales tax" for farmers, bankers, manufacturers, merchants, holding companies investment companies, chain stores, etc., planned somewhat after the present income tax?

This plan would permit the average farmer, merchant, manufacturer, etc., to exist and unemployment would cease to be a national problem.

THE PLAN

The basis for taxation under the step-rate sales tax plan would be the average sales of the total aggregated annual sales in each line of business in the United States.

A business making less than the average amount of sales to pay no step-rate sales tax.

A business making twice the average amount of sales to pay the basic tax rate for all sales over the average sales.

The business making three times the average amount of sales to pay the basic rate on sales over the average, and twice the basic rate on sales over twice the average.

A business making 4 times the average amount of sales to pay the basic rate on sales over the average, and twice the basic rate on sales over twice the average, and 3 times the basic rate on sales over 3 times the average.

Thus the base amount for a banker may be \$10,000,000, so that a banker doing a yearly business of \$15,000,000, pays nothing for the base amount of business but only for the amount above the average, which would be \$5,000,000, and if 1 percent were fixed as the basic tax, \$50,000 would be his tax for that year.

If, however, the banker did \$27,000,000, he would pay nothing for the base amount, 1 percent on \$10,000,000 over the base amount equals \$100,000 and 2 percent on \$7,000,000 equals \$140,000, making a total of \$240,000. His income at 5 percent on \$27,000,000 would be \$1,350,000 from which he would pay a step-rate sales tax of \$240,000 leaving a gross profit of \$1,110,000.

The farmer's base amount may be but \$5,000.

Steel industry may have a base amount of \$300,000.

It may seem that a system of this kind would be complicated, but as a matter of fact the Government would find it to be much less complicated than the income-tax plan.

Any one of the 850 codes of industry is now more complicated than the step-rate sales tax plan.

The Government should make but one basic tax rate for all industries, bankers, manufacturers, farmers, etc. This basic rate could be one-half of 1 percent or it could be 1 percent.

The Government could easily determine what the basic rate should be—by studying the income tax returns to ascertain the gross amount of sales in each line of business.

This basic rate should be made solely for the purpose of fostering legitimate employment for all and it should be regulated each year according to the general prosperity of all the people.

A Federal step-rate sales tax, reapportioned to the States from which the tax emanated, would sustain the States, promote the reemployment of all, eliminate in the shortest possible time the need of unemployment relief, and advance general prosperity.

Figures from Government statistics show that one-third of the printing establishments failed between 1929 and 1933.

The tax would affect the remaining printers, assuming that 1 percent was to be the base rate, as follows:

Base sales—\$56,000.

Sales up to \$56,000 will not be taxed.

Sales up to \$112,000 will be taxed \$560.

Sales up to \$168,000 will be taxed \$1,680.

Sales up to \$224,000 will be taxed \$3,360.

Sales up to \$280,000 will be taxed \$5,600.

Sales up to \$336,000 will be taxed \$8,400.

Sales up to \$392,000 will be taxed \$11,760.

Sales up to \$448,000 will be taxed \$15,680.

Sales up to \$504,000 will be taxed \$20,160.

Sales up to \$560,000 will be taxed \$25,200.

Sales up to \$616,000 will be taxed \$30,800.

Sales up to \$672,000 will be taxed \$36,960.

Sales up to \$728,000 will be taxed \$43,680.

Sales up to \$784,000 will be taxed \$50,960.

Sales up to \$840,000 will be taxed \$58,800.

Sales up to \$896,000 will be taxed \$67,200.

Sales up to \$952,000 will be taxed \$76,160.

Sales up to \$1,008,000 will be taxed \$85,680.

The tax will not "soak" the rich nor destroy the superplants, but it has for its object the fair distribution of our producing power, so that all may earn a fair share of our abundance.

Each line of business will have a different base amount, according to the aggregated amount done in each line, divided by the number of establishments; this will give the base amount of business for the purpose of taxation.

Would it not be far better to have 97 percent of average farmers, merchants, manufacturers, etc., employ 40,000,000 persons than to have the remaining 3 percent, which are monopolies, control all production and employ but 10,000,000 wage earners?

This step-rate sales tax, if inaugurated, will be a blessing rather than a burden to our people.

It will sustain the Government with honest taxes.

It will put everyone to work and increase wages.

It will create fair prices for foodstuffs and merchandise.

It is not so much the price that disturbs the modern man as it is the inequality of opportunity.

It will not be necessary for the Government to waste another \$350,000,000 to stabilize the price of wheat.

It will not be necessary to use grain as fuel in order to get the surplus off the market while the people are being fed by charity.

It will not be necessary for Mr. Wallace of the Farm Board to rent part of the monopolistic farms in order that they may not grow too much grain.

It will not be necessary to give the large cotton growers the same kind of graft in order to advance prices.

Is it not time that the average business man be protected from monopolistic enterprises?

To run a factory, to employ labor, or form a corporation or a holding company, is not a natural right. It is a social privilege. Those who have abused that privilege should be curtailed in such a manner so as not to permit of further monopoly.

Democratic platform, 1932: "Equal rights to all, special privileges to none."

Republican platform, 1932: "With courage and confidence in ultimate success, we will strive against the forces that strike at our social and economic ideals."

Socialist platform, 1932: "Steeply increased inheritance taxes and income taxes on the higher incomes and estates of both corporations and individuals. A constitutional amendment authorizing the taxation of all Government securities."

Farmer-Labor platform, 1932: "Prohibit by law, holding companies, corporation farms, and chain stores. Strict enforcement of the antitrust law."

Prohibition platform, 1932: "To aid agriculture we favor the equalization fee, or such other measure as may be agreed upon by the leading farm organizations of the United States."

"The total volume of dividend payments in the United States in midyear, 1932, was 72 percent above the levels of 1926. And the total volume of payrolls in the United States, at exactly the same time was 55 percent below the 1926 levels. For 10 years before the depression, dividends went up eight times as much as pay rolls. Business, unregulated, selfishly paid its stockholders huge dividends—most of them out of surplus—in the middle of the depression, while employees begged, went on the dole—or starved.

Statistics have from year to year, and even month to month, pointed to the fact that free and unbridled competition was eventually leading to the elimination of the small, and gradually but surely to the larger business men and manufacturers.

Statistics have shown that the cumulative effect of the gigantic machines of production, in fewer and fewer hands, would be so tremendous as to get beyond the possibility of control by the few industries.

Statistics have shown that it would eventually become impossible for the monopolies to dispose of their surplus in either domestic or foreign markets.

Statistics have shown that monopolies would eventually accumulate and lie like an incubus on the chest of humanity preventing it from breathing and living while a multimillion army of unemployed would tramp the streets and highways unable to find the wherewithal to live.

It will thus be seen that the depression is the effect.

Free and unbridled competition is the cause. It will be seen that unbridled competition has reduced the purchasing power of the many and placed it in the hands of the few.

It will be seen that a monopoly producing 100,000 units at no profit to itself is a menace to society. The Government receives nothing in taxes, thus proving the income tax to be insufficient and incompetent for industry.

This applies equally to the Wall Street financial magnates who may transact business amounting to \$1,000,000,000 and pay no income tax, nor corporation tax, and yet have millions of Government tax-free bonds in their coffers.

The step-rate sales tax would correct this evil.

By referring to the enclosed chart it will be seen that one superestablishment or monopoly will produce as much as will 25 average establishments, and as conditions stand today it will show:

1 superestablishment will employ	645
25 average establishments will employ	2,500
1 super-establishment will show a weekly pay roll of	\$13,222

25 average establishments will have a weekly pay roll of.....	31, 250
1 superestablishment will show a weekly profit of.....	19, 400
25 average establishments will show a weekly profit of.....	10, 375

The second stage of the chart, after enacting the step-rate sales tax, shows that 5 superestablishments will produce as much as will 25 average establishments.

5 superestablishments will employ.....	3, 445
25 average establishments will employ.....	7, 450
5 superestablishments will have a weekly pay roll of.....	\$103, 350
25 average establishments will have a weekly pay roll of.....	171, 350
5 super establishments will show a weekly profit of.....	83, 000
25 average establishments will show a weekly profit of.....	50, 000

The third stage of the chart, after enacting the step-rate sales tax, shows that 7 superestablishments will produce as much as 25 average establishments.

7 superestablishments will employ.....	5, 138
25 average establishments will employ.....	8, 650
7 superestablishments will have a weekly pay roll of.....	\$159, 278
25 average establishments will have a weekly pay roll of.....	212, 600
7 superestablishments will show a weekly profit of.....	101, 430
25 average establishments will show a weekly profit of.....	84, 000

In a very short time after enacting the step-rate sales tax, to produce practically the same number of units, the chart will show:

	<i>Percent</i>
Commodities will increase from 5,300 to 5,900 or.....	11
Total sales will increase from \$159,000 to \$236,000 or.....	43
Employment will increase from 1,845 to 2,976 or.....	61
Total wages will increase from \$34,257 to \$82,317 or.....	131
Individual wages will increase from \$18.50 to \$27.20 or.....	50
Commodity prices will increase from \$30 to \$40 or.....	33
Profits will increase from \$38,994 to \$44,793 or.....	15

This will show that the total monopolistic profits are now 13 percent greater than wages, and it will further show that after enacting the step-rate sales tax the total wages will be 80 percent more than the profits, even though the total profits increased 15 percent for large and small and industries.

When the step-rate sales tax is put into effect:

Confidence in the future will be restored to all.

Small and average industries as well as large industries will balance their budgets.

The Government may balance its Budget and attend to its own proper functions.

If our forefathers had foreseen the disastrous effects of monopolistic competition, the Constitution of the United States would have contained a clause prohibiting indiscreet production. The clause would probably have been a Federal step-rate sales tax.

The Constitution is still the most perfect document ever devised to establish justice, insure domestic tranquillity, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity. Under this logical instrument this Nation has prospered for 150 years.

Those of us who would change the Constitution would likely try to change the Ten Commandments.

The object of the step-rate sales tax is to keep super-manufacturers and super-farmers from everlastingly trying to produce in such overwhelming quantities that they finally break the less fortunate average farmer and manufacturer.

The principle of diminishing returns on production will not restrict initiative, but will eliminate unfair competition, and will accomplish everything that is desired by the National Recovery Administration without running counter to the Constitution nor to the natural laws of supply and demand, and will make recovery a fact.

The very unfair advantage of super-plants, with their most efficient labor-saving, mass-producing machinery, and their lower costs for materials, lower overhead expense, lower wage cost per unit, and therefore their lower selling price, is defeating most of the average manufacturers and farmers.

The prompt reemployment of the masses in regular channels is the most important need of the hour. Honest labor wants nothing more than an equal opportunity to earn a fair living for himself and family.

Monopolies will insist on the continuation of the codes in order to further forestall the anti-trust laws.

Since all of the anti-trust laws have failed to work, there remains but one solution to our economic problem and that is a Federal step-rate sales tax.

FARMERS

Great wheat growing corporations with 50,000 acres (78 square miles) and 135,000 acres (211 square miles) are producing more than twice as many bushels of wheat per acre as the average farmer. The average farmer produces 14 to 16 bushels of wheat to the acre, while some of the better equipped and scientifically trained farmers have produced 75 bushels to the acre.

"At the rate we are going, when the average farmer produces 70 percent of that of our best farmers, 47,000,000 acres will supply the same quantity of product as we now obtain from 214,000,000 acres, and 2,500,000 men will be able to do the work now done by 12,500,000."

MANUFACTURERS

The cost in labor and materials used in producing 1,000,000 automobiles selling for \$545 each is but \$108, while the manufacturer producing but 100,000 similar cars, even though he pays lower wages and works longer hours, finds his cost for labor and materials to be \$420 each. The manufacturer of the 1,000,000 cars advertises that over 800 automobile manufacturers have failed since the advent of his car.

BANKERS

"Out of 14,000 financial institutions in this country, 25 such institutions control two-fifths of all the Nation's bank credit resources. Since December 31, 1932, the 25 largest banks have increased their deposits \$1,020,000,000 during a 6-month period in which deposits in all other banks have dropped more than \$4,000,000,000. While the small banks disappeared, the big ones increased their domination."

The lack of purchasing power is caused by unemployment, and unemployment is caused by monopolies.

Twenty-five average establishments employing a total of 2,500 men will produce no more finished commodities than one super-plant employing but 645 men. For each mass producing super-plant employing 645 men, 25 average establishments must fold up and disappear, thereby throwing 1,855 men out of employment.

Establishments operating

In 1859 there were	140, 433
In 1879 there were	253, 852
In 1899 there were	512, 191
In 1929 there were but	210, 959

Each year since 1929, 16,794 establishments have ceased to exist, or have been taken over by monopolies, and our population has increased 54 millions since 1899.

Too little is produced by the many and too much by the few.

All wealth is created by labor, so that if we unduly cut hours of labor, at this time, we likewise cut general wealth. When the farmer can do his day's work in 5 hours, the artisan should work but 5 hours. Until then it is imposition to have the farmer work 12 hours to produce that which the artisan needs, while the artisan works but 5 hours to produce that which the farmer needs.

It is as impossible to stabilize the price of wheat and cotton by spending millions upon millions of dollars to plow under these commodities, as it is to fix prices for all other commodities. To attempt to regulate wages, in spite of the law of supply and demand, is just as impossible.

If a tariff to protect our farmers and manufacturers from foreign competition be logical (and I am sure it is), surely a tax to protect the average employee, the average farmer, and the average manufacturer from the monopolistic manufactures and farmers at home is most logical.

Does it make the misery any less real to have foreign or home industry restrict profitable employment?

Our American plan of democracy is fine. Individualism makes life worth while, both for employer and employee.

The sixteenth amendment to the Constitution makes the step-rate sales tax feasible, and taxes in progressive proportion to the amount of business done is justifiable. The Government has all the essentials necessary to put this tax into effect, and can enforce it with greater success than the income tax.

The step-rate sales tax should be levied on manufacturers, bankers, farmers, merchants, and on all industry—

First: To save the average industries, which in the aggregate will employ the most help, and extend the most purchasing power.

Second: To save the larger industries, by reducing their production and increasing the purchasing power of the many.

Third: To instill a confidence in all men that gigantic monopolies will not destroy them in the future.

Fourth: To sustain the Government with honest taxes, received from those best able to pay.

The step-rate sales tax should be used as a regulating medium for capital and labor.

Since it is quite evident that small plants, nor monopolies, can now profitably expand because of the lack of purchasing power, which must be furnished by 97 percent of our population (average laborer, farmer, manufacturer, merchant, etc.) it follows that capital cannot be safely employed in either small or large industries, and it therefore flows to the United States Treasury to be doled out as charity, only to find a dead end.

If the step-rate sales tax is put into effect, credit will expand and capital will flow to the average industries, which will give profitable employment to all our people, and therefore create the desired purchasing power.

Failure of consumption through unemployment will cause another even greater crash unless the Government acts decisively now.

Until confidence is restored, we cannot make any permanent advance over depression.

INCOME TAX INJUSTICE

"Men who can buy only two suits of clothes a year must pay the Government more income tax than the two suits cost them.

"Men whose wives skimp and worry over the family food budget pay the Government income tax.

"J. P. Morgan has four sumptuous homes and a yacht. For 3 years he has paid no income tax.

"Otto H. Kahn spends hundreds of thousands maintaining his position as a patron of art and music. For 3 years he has paid no income tax.

"Why?

"Because our income tax law makes it possible for the Kahns and the Morgans to write off their losses in bad years and avoid contributing to the expenses of Government.

"Kahn is able to sell his securities at a loss and have his daughter buy them back and present them to him. He deducts his loss and keeps his securities. This is perfectly legal.

"No law can be drawn to make a distinction between a sale of property to show a loss for tax purposes and a real sale.

"The distinction lies in the conscience of the individual, a domain into which no law can reach.

"But the law that makes this situation possible is manifestly unfair. A way must be found to make those who live in luxury relieve the small-salaried man of his crushing tax burden."

The solution is a step-rate sales tax.

Professor Tugwell states that 200 large industrial corporations do more than 50 percent of all the business done in the United States, and that representatives of these monopolies gathered in Washington and induced the President to inaugurate the National Recovery Act, better known as the N. R. A., in order to increase the purchasing power of the masses.

These corporations employ less than 2,700,000 workers out of 49,000,000 workers in the United States. Their profits in the last 6 months, as stated in The Literary Digest, was \$408,572,000 against \$157,579,000 in the first half of 1933.

While average business was showing no profit, the large corporations were showing substantial gains.

This would indicate that the money doled out of Washington is flowing steadily to the monopolies, and legitimate employment is less than during March 1933.

Does this not explain the cause of unemployment, and the cause of the depression?

Billions of dollars more will have to be expended by the Federal Government, the States, and private charity if some such plan as the step-rate sales tax is not inaugurated promptly.

A reasonable computation of the effect of the step-rate sales tax proves that this system of taxation would make legitimate work for all our unemployed and that a general sales tax would aggravate the depression.

The ultimate aim of the step-rate sales tax is to force economic control of industry by just taxation, to the end that all may be profitably employed.

The psychological effect of President Roosevelt's promised "new deal" early in 1933 saved our country from a calamity, the far-reaching consequences of which can only be conjectured.

Many causes are thought to be responsible for the depression, but it is a well-known fact that the primary cause is that too much is produced by the few and too little is produced by the many.

Today over 50 percent of all production is produced by one-sixth of 1 percent of all producers. Out of 14,000 financial institutions, 25 such institutions control more credit than all the others put together. If the few would produce less, the many will produce more, profitable employment will follow, and purchasing power will be the natural sequence.

During the past 12 months no logical plan has been attempted to correct the evil of concentrated production.

Instead of a tried, sound, and practical solution, we experimented with plowing under wheat, cotton, corn, pigs, etc., not for the purpose, however, of distributing production among the many, but for the purpose of curtailing general production. This plan has failed to relieve the condition, and the consumer and taxpayer must foot the bill.

Then the codes of industry: The most horrible thing about it is the fact that the codes foster class strife.

In effect the codes say: "Mr. Industrialist, you must organize and combine with those in your line to raise prices and we will close our eyes to these illegal practices, and we will blot out the Constitution and anti-trust laws, and you may jointly soak the consuming public all it will stand. But for this privilege you must allow the union to run your business, and you must be sure to allow the American Federation of Labor to be the dictator. No cooperative unions allowed."

Secretary of Agriculture Wallace states that there will be no protective tariff for the inefficient farmers. It is time then to ask by what yardstick is efficiency to be measured?

If the farmer is to be measured by the efficiency of the great wheat growers' corporations, hog raising corporations, or any of the great monopolistic specialists, then the farmer had better join the long, long dole line.

The manufacturer who cannot show the efficiency of the mass production monopolists had better apply for the dole, too.

The merchant who finds he cannot compete with the chain stores should prepare for his demise.

It is no wonder that the farmer complains about the Government's artificial price raising of everything he needs, by reducing hours and increasing wages in all lines but farming. If the average producer reduces his prices and sells his product in order to get a crumb of business, he is called a chiseler. If a monopoly reduces its charge in order to drive out other producers, the monopolist is considered a benefactor.

A chiseler is usually found to be a person doing a relatively small amount of business; by cutting his prices in order to get work and pay his employees, he hopes by honest effort to pay his bills and keep his family from the dole line.

A benefactor is usually a financial magnate having great mass-producing machinery and by reducing his prices hopes to make larger profits by driving the chiselers into the dole line.

The "new deal" keeps us continually upset and hinders the revival of business. But as long as the Government finds it necessary to dole out enough money to keep us from starving in a land of plenty, this waste may prove to be the salvation of the country by compelling the Government to place taxes where they belong—on all businesses by a step-rate sales tax, planned somewhat after the step-rate income tax.

This plan will not permit the producers to pass the tax on to the consumer.

It will distribute production.

It will make profitable employment for all.

It will create the desired purchasing power.

Since wages are relative, the Government has been a party to the reduction of wages, by increasing the price of everything the citizen needs.

A short time ago a worker earned 1 ounce of gold for a week's work, whereas he must now work $1\frac{1}{2}$ weeks for the same amount of gold.

Why make criminals of honest business men with code penalties and impossible rules?

The belittling of individualism and the forced goose-stepping of both employee and employer savors of tyranny. The cancerous growth of monopolies is contrary to our American ideals, and is the cause of most of the misery, not only in this Nation, but in most all of the other countries. It will be the controlling cause of future wars.

The step-rate sales tax will frustrate the boundless acquisition of trusts; it will cure the cancer and will not kill the hogs.

If the Nation at large knew that some such tax was to be a reality in the near future, that fact alone would be a great stimulant for reemployment. Capital would expand; banks would loan; and real values would be in ascendancy. It can be handled with greater ease, accuracy, and fairness than the income tax.

"When labor will produce more cheaply than machinery, the machine will be quickly withdrawn and pay rolls increased."

This is true, but it is not desirable to handicap the machine. The machine makes it possible for each of us to share in our national abundance. But our trouble is that too much is produced by the few, and the step-rate sales tax will reduce the production by the few and increase the production by the many to the point where all can be employed.

When the tax is enacted into law there will be little need for anti-trust laws, Wagner bills, old-age assistance, and opportunities and individualism will make life worth-while for all of us.

FEDERAL STATISTICS OF MANUFACTURERS FOR 1925

In 1925 there were 187,390 establishments producing \$62,713,713,680 and employing 8,384,261. A Federal step-rate sales tax does not propose an equal division of production but if the production were fairly divided amongst all the manufacturers, each manufacturer would produce \$334,669, and employment in establishments would increase—making work for 12 out of each 100 of population. This would cause work for one-third as many more employees as are available.

Class 1.—There were 55,876 manufacturers producing between \$5,000 and \$20,000, averaging \$11,245, employing 156,373; total production, \$628,373,403; average production per man, \$4,018.

Class 2.—There were 68,951 manufacturers producing between \$20,000 and \$100,000, averaging \$47,357, employing 660,309; total production, \$3,272,196,-822; average production per man, \$4,955.

Class 3.—There were 42,209 manufacturers producing between \$100,000 and \$500,000, averaging \$226,873, employing 1,675,911; total production, \$9,576,-090,022; average production per man, \$5,714.

Class 4.—There were 9,771 manufacturers producing between \$500,000 and \$1,000,000, averaging \$703,112, employing 1,131,439; total production, \$6,870,-112,293; average production per man, \$6,072.

Class 5.—There were 10,583 manufacturers producing over \$1,000,000, averaging \$4,003,301, employing 4,760,229; total production, \$42,366,941,140; average production per man, \$8,900.

The manufacturers in class 5 could pay each of their employees a weekly wage of \$54 in addition to that amount which their employees now receive, without making their competition more keen than class 4.

The manufacturers in class 4 could pay each of their employees a weekly wage of \$7 in addition to the amount which their employees now receive, without making their competition more keen than class 3.

The manufacturers in class 3 could pay each of their employees a weekly wage of \$14.50 in addition to the amount which their employees now receive, without making their competition more keen than class 2.

The manufacturers in class 2 could pay each of their employees a weekly wage of \$18 in addition to the amount which their employees now receive, without making their competition more keen than class 1.

In 1930 there were 6,288,648 farms averaging 156.9 acreage. Two-fifths of our total population lived on farms and were engaged mostly in agricultural pursuits.

The average farmer produces 16 bushels of wheat to the acre, so that if the farmer produced wheat on his acreage and sold it for \$1 per bushel, his income would be \$2,510; while the great wheat-growing corporation with 50,000 acres, producing 32 bushels to the acre, selling for \$1 per bushel, would have an income of \$1,600,000—produced at less than one-fourth the cost in wages per bushel, as compared with the average farmer.

Too much is produced by the few and too little by the many.

A Federal step-rate sales tax would make it possible for most all farmers to be prosperous, without the unjust processing tax.

TABLE SHOWING THAT THE NATIONAL RECOVERY ACT IS UNFAIR TO THE AVERAGE BUSINESS

Weekly profit and cost sheet of small and large business

	Small company	Large company
Units produced.....	100	2,500
Total sales.....	\$3,000	\$75,000
Number of employees.....	100	645
Average wage.....	\$12.50	\$20.50
Cost in wage per unit.....	\$12.50	\$5.29
Unit sales price.....	\$30.00	\$30.00
Overhead, interest, depreciation.....	\$5.25	\$3.00
Material cost.....	\$7.80	\$6.45
Total cost per unit.....	\$25.55	\$14.74
Profit per unit.....	\$4.15	\$15.26
Weekly profit.....	\$415	\$38,150

Twenty-five small businesses will employ 2,500 men to produce the same number of units as will one large business employing but 645 men. One large business employing 645 men will displace 1,855 men.

The so-called "saving clause" in over 50 percent of the codes, permits selling below cost when necessary to meet competition, it does not authorize a concern to initiate reductions that bring its prices below its own costs. The producer who is selling below cost can follow prices down, but cannot force them down. The initiative must come from those who can cut without violating their costs.

A Federal step-rate sales tax would make it possible for the small companies to exist and increase wages, and unemployment would cease to be a problem, while the continuing of the National Recovery Act will foster strife and misery for still greater numbers of the unemployed.

The Government will have to correct the cause of unemployment, or else continue to increase the amount of unemployment relief until it can do so no more—what then?

For 30 years the Government Statistical Department has had the facts to prove that there must be 9 out of each 100 of our population employed in establishments to equalize our economic order:

In 1919 there were 8.62.
 In 1929 there were 7.30.
 In 1930 there were 6.25.
 In 1931 there were 5.24.
 In 1932 there were 4.25.
 In 1933 there were 3.75.
 In 1934 there were 3.28.
 In 1935 there were ?.

A Federal step-rate sales tax will effect the return of the masses to profitable employment and when the average of 9 to 100 of our population are engaged in establishments, general prosperity and happiness in the United States will be greater than the world has ever known.

At the present time, one employee in super-plants or monopolies will eliminate more than four employees in average plants.

A progressive rate of tax from 10¼ to 16¼ on the net incomes of business will not help the unemployment situation; it will reduce employment by forcing the larger concerns to speed up on their labor-saving machinery in order to meet this extra tax; they too will reduce their prices and increase their output, thus driving out of business their competitors.

It seems to me that when there is a tax plan available that will encourage very many more enterprises than it will discourage, that will force back into their regular trades the unemployed; that will balance the budget and bring general prosperity; any tax plan that will not do just that will be wasting money—more unemployment—more taxes.

If our president will, through some such method of taxation, place the unemployed masses back into their legitimate enterprises, our national leader will continue to be Franklin D. Roosevelt.

The CHAIRMAN. Gen. R. E. Wood, president of Sears, Roebuck & Co., Chicago, Ill., had been scheduled to appear before the committee. However, he is unable to be present and has written me a letter which I will have placed in the record at this point.

(The letter from General Wood is as follows:)

SEARS, ROEBUCK, & Co.,
Chicago, July 30, 1935.

HON. PAT HARRISON,
Chairman Finance Committee, United States Senate,
Washington, D. C.

MY DEAR SENATOR HARRISON: I appreciate your courtesy in inviting me to appear before the Finance Committee. However, I received the notice too late to be able to be present.

I have nothing to say on the subject of individual income, inheritance, and gift taxes. While there is some doubt in my mind as to their economic soundness and while they may hurt personally, nevertheless, as a good citizen I am prepared to accept any rulings that Congress, in its wisdom, may see fit to make.

I am, however, absolutely convinced of the unsoundness and unfairness of the graduated corporation tax. I enclose copy of a letter I wrote to Mr. Doughton on the subject.

From the standpoint of our own corporation, the largest stockholder at present is the Employees' Profit Sharing Fund, which holds 440,000 shares of stock, distributed among 23,000 employees. Besides this, there are 29,000 other stockholders, the overwhelming majority of which are people of very limited means and who own stock in small amounts.

I am having an analysis of this corporation's stock list made which I will be able to furnish later on, as it is not completed as yet. I will say off-hand that not over 25 percent of the stockholders of this corporation consist of wealthy families or individuals, and that 75 percent of the stock is held by people of limited means and in small amounts. The graduated tax penalizes these people for no good purpose.

Sincerely yours,

R. E. Wood.

WASHINGTON, July 11, 1935.

HON. ROBERT L. DOUGHTON,
Chairman Ways and Means Committee of the House,
Washington, D. C.

MY DEAR MR. DOUGHTON: Since I was unable to appear before your committee today, I desire to have this letter placed in the record of the hearings.

While I agree in principle with the proposed inheritance taxes and increases in personal income taxes, though I have not studied the rates, I must oppose the proposed graduated corporation tax.

In my opinion, this is an unjust and discriminatory tax levied on mere size of the business unit and without any relation either to the rate of profits the business may produce for its stockholders or to the number of stockholders that may have pooled their investments to create the business. The small corporation making a very large percentage of profit would be taxed at a lesser rate than the large corporation making a very small percentage of profit, and the wealthy owner of most of the stock in a small or medium-sized corporation would enjoy a decided tax advantage over the person of moderate means who may own a few shares of stock in a large corporation.

The proposed graduated corporation tax completely violates the universally accepted principle that taxes should be levied in accordance with ability to pay. Tax experts, including those of the Treasury Department, have heretofore consistently upheld the principle of a uniform rather than a graduated corporation tax.

Even the social reformers who, for one reason or another, feel that some restriction should be invoked against the growth of corporations, have never heretofore, so far as I can learn, recommended a graduated corporation tax as the

means of accomplishing their purpose. Mr. Justice Brandeis, whose book "Other Peoples Money" is credited with being the inspiration for the present agitation against size in corporations, was inveighing merely against size attained by uneconomic consolidations brought about mainly by investment bankers for profit. The new Securities Act and the new Banking Act will do much toward curbing abuses of this kind.

Gardiner Means, whose writings appearing as Senate Document No. 13 are sometimes referred to as the basis of the present proposal for graduated corporation taxes, certainly did not argue that remedy. On the contrary, he argued for a certain degree of governmental control over industrial policy (as in N. R. A.) and definitely pointed out that the alternative "would require the breaking up of large corporate units into a very great number of separate and wholly independent competing enterprises with the loss in efficiency which it would entail."

It appears, therefore, that this proposal can be justified neither on the basis of sound taxation nor as a social reform measure. It will not even raise a material amount of revenue.

On the other hand, the adoption of the graduated corporation tax would introduce into business a disturbing element of far-reaching consequences. This would be a step backward toward "horse-and-buggy days." The principle established the spread between the highest and the lowest rates could be readily widened and perhaps applied to specific lines of business to attain political rather than desirable economic or social purposes.

With proper restraints upon consolidations and mergers and proper enforcement of the antitrust laws, the question of the optimum size of corporations in any particular line of business, will take care of itself; there are natural limitations of managements, excessive overhead, remoteness from customers, and similar factors which cut into efficiency and under competitive conditions determine the optimum size of the business unit.

I feel that it would be a grave error to inject the graduated corporation tax principle, with its serious economic consequences, and I hope that your committee will eliminate this feature from the bill.

Very truly yours,

R. E. WOOD, *President.*

The CHAIRMAN. The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at the hour of 11:55 a. m., the committee recessed until 10 a. m. the following day, Thursday, Aug. 1, 1935.)

REVENUE ACT OF 1935

THURSDAY, AUGUST 1, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

Present: Senators Harrison (chairman), King, George, Barkley, Connally, Gore, Costigan, Clark, Byrd, Lonergan, Gerry, Guffey, La Follette, Metcalf, and Capper.

The CHAIRMAN. The committee will be in order. All right, Mr. Secretary.

STATEMENT OF HON. HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY

Mr. MORGENTHAU. Mr. Chairman and members of the committee, I am pleased to respond to your invitation to appear before you and to discuss briefly pending tax proposals. On July 8 I had an opportunity to make a statement to the Ways and Means Committee of the House of Representatives, which was then about to begin preparation of a tax bill to give effect to the recommendations contained in the President's message to the Congress of June 19. That statement summarized the Treasury's position with respect to the President's recommendations, and I should like to have you regard it as a part of my statement here today. I will read it if you wish, Mr. Chairman.

The CHAIRMAN. It was introduced before the Ways and Means Committee?

Mr. MORGENTHAU. Yes.

The CHAIRMAN. It is not necessary to read it.

Mr. MORGENTHAU. The President, in the message to which I have referred, stated that his recommendations were based on studies of our tax system carried on in the Treasury Department as well as the excellent research work done by the staff of the Joint Committee of Congress on Internal Revenue Taxation. All of the data gathered by the Treasury Department will of course be made freely available to your committee. I should like to refer particularly to studies carried on by Mr. Robert H. Jackson, counsel of the Bureau of Internal Revenue. Mr. Jackson has summarized and analyzed a great deal of data from income tax and estate tax returns which bear directly on the President's recommendations. He is prepared to present this summary and analysis to you.

I shall not attempt to review the data that has been gathered, but only to indicate its scope. It deals with such questions as these:

The extent to which our national revenues are now derived from taxes laid directly on the consumer and the extent to which they are derived from taxes based on the ability to pay.

The changes in the balance of taxation as between these two classes that have been brought about by the depression and other causes within the last few years.

The distribution of income and the degree of concentration of high incomes.

The effectiveness of income-tax rates as modified by various devices for escaping taxation.

Whether existing surtax schedules are fully consistent with the principle of ability to pay.

The actual yield of present estate taxes as related to the size of estates.

Devices for avoiding estate taxes.

Problems of administering and collecting an inheritance tax.

Stability of yield of a graduated corporation income tax as compared to stability of yield of a flat tax rate.

Extent of the concentration of income and of assets in the hands of large corporations.

I cite this material merely to indicate the willingness of the Treasury to offer such assistance to your committee as you may desire.

In conclusion, I want to add an earnest word as to the use to which any additional revenue that the proposed new taxes will produce should be put. Ordinary expenditures for the general purposes of Government have been held within the revenues. We have incurred and are incurring large emergency expenditures according to a carefully planned program for the sole object of caring for the urgent needs of our citizens and promoting recovery. Additional revenue which will necessarily fall short of meeting our full needs will not warrant new or additional expenditures outside our Budget plans. Any such new or additional expenditures would not conform to the best interests of the national credit. I hope the Congress will provide that the proceeds of the new taxation you are considering shall be preserved scrupulously for the purpose, first, of reducing the deficit, and, later, of reducing the public debt.

The CHAIRMAN. Now, Mr. Secretary, I want to ask you some questions with reference to this bill. There are some of us who are quite willing to go along with the recommendations made by the President in his message, but the bill that has been presented to the House, to the minds of some of us does not conform strictly to the President's recommendation. Can you tell the committee whether or not, in your opinion, it conforms to the President's recommendations?

Mr. MORGENTHAU. Mr. Chairman, if you will be patient with me a minute, in answering your direct and clear question. Your committee has its experts and the Treasury have theirs. You place me in a very embarrassing position when you ask me practically to analyze a bill that has passed the House.

The CHAIRMAN. It has been introduced, it has been reported out by the committee.

Mr. MORGENTHAU. Well, it is pending before the House. If I attempt to answer your question, I do not know whether I am able to, but if I attempt to answer it I immediately have to get into the discussion of rates and schedules, and the position that I have taken, since I have been Secretary of the Treasury, is that it is not proper, or within my province, to attempt to tell Congress what the rates and schedules of any revenue bill should be. I have always attempted to place at your disposal, and the disposal of the Ways and Means Committee, all the facilities of the Treasury on any technical question, and I feel any time that your committees have called on us for technical information we have always given it as quickly and rapidly as it was within our power to do so, and I do hope you will not ask me to analyze the bill which is now pending before the House.

The CHAIRMAN. Mr. Secretary, it is not only to keep from embarrassing you but trying to remove us from an embarrassing situation that I am asking you these questions. You need not answer them if you do not desire to answer them. I have had numerous conferences with the President, as you have, with reference to the President's suggestions. It matters not whether I agree with the President's philosophy on this thing, but evidently it is based upon the work of the Treasury Department, because it is inconceivable that the President would make any recommendation to Congress without first conferring with the Secretary of the Treasury and the Treasury experts. As I stated, there are some of us that desire to go along with the President, as we have done. That is my desire.

He recommends on a graduate corporation tax a graduated scale from 10.75 percent to 16.75 percent. The House has greatly modified that and they work it within one-half percent variation, from 13.25 to 14.25 percent, and then in addition to that they put an excess-profits tax on it. I want to know whether that procedure is approved by the Treasury Department or by the administration. I am asking it as a guiding post for the consideration of the committee.

Mr. MORGENTHAU. May I confer for a minute, please?

The CHAIRMAN. Yes.

Senator KING. While the Secretary is conferring may I say, as much as we desire to go along in the footsteps indicated by the President, speaking for myself, and myself only, I intend to vote for or against this bill dependent upon my own judgment, after full consideration of all the facts. I will try, of course, to keep before me the recommendations of the President. He has the right to make recommendations, but it is the duty that rests upon Congress to determine for itself what kind of legislation is necessary, whether it be fiscal legislation, revenue legislation, or any other kind of legislation.

The CHAIRMAN. I agree with you thoroughly on that proposition, but I think in view of the President's message, we have a right to know whether or not the administration has changed its views with reference to this item, and with reference to other items. If they have changed, I am willing to go along with the changes but I do not want to get caught coming and going on this proposition.

Senator BARKLEY. Mr. Chairman, it seems to me it is easy for anybody to read the President's message and read the bill and make up his own mind whether or not it conforms with the President's message. I understand the Ways and Means Committee went outside of the scope delineated by the message of the President to put in

some schedules that were not mentioned. Whether the Ways and Means Committee obtained information from the Treasury experts upon which it has based its judgment I do not know, but it is entirely possible that the Ways and Means Committee acted on its own volition in making some changes in the bill as suggested by the President. We can either go along with the Ways and Means Committee or we can change it as we see fit, or we can adapt from the President's suggestion something that is wise or good. I do not understand that any committee necessarily is bound by the technical terminology of any message as to the writing of the revenue bill.

The CHAIRMAN. I agree with you.

Senator BARKLEY. I do not know whether we ought to require the Treasury Department, which has furnished the Ways and Means Committee any information it desired, to categorically say whether it approves or disapproves any departure on the part of the committee from the recommendations of the President. That is the way I feel about it.

The CHAIRMAN. Of course the committee has got a right to make any rates they want to as a general proposition, but I think the committee is entitled to get the views of the Treasury on this change.

Now, will you answer the question, Mr. Secretary?

Mr. MORGENTHAU. Mr. Chairman, I will try to answer it. The President's message I think is very clean cut. It is a simple statement that I think anybody can understand. Now where the bill pending before the House varies from that it is very simple to tell. I have people here, just as you have, Mr. Parker, who can tell you in technical language where the House bill varies from the President's message.

As to the reference in the President's message as to the information gained from the Treasury on which his message is based, Mr. Jackson is here and is ready, and would like to, and I hope you will give him the opportunity, to present the information which the Treasury has on which the President's message was based.

The CHAIRMAN. We will give Mr. Jackson that opportunity. Do you approve, as the Secretary of the Treasury, the changes which are made in the House bill from the recommendation of the President?

Mr. MORGENTHAU. Senator, I do not feel it is up to me, as an appointed executive officer, to approve or disapprove any action of Congress.

Senator KING. I think you are right.

The CHAIRMAN. I think you could certainly give to this committee your views as the Secretary of the Treasury.

Mr. MORGENTHAU. As secretary of the Treasury my views are those which are contained in the President's message.

The CHAIRMAN. Well, the House bill does not have the views then contained in the President's message.

Mr. MORGENTHAU. If the House differs from the President's message, where they differ they have used their prerogative to form a law, as to what they think a tax measure should be.

The CHAIRMAN. Is it your opinion, as Secretary of the Treasury, that we would get more revenue out of the rates fixed for 10.75 percent on a graduated scale up to 16.75, without the excess profits tax, or according to the policy laid down in the House bill arranging the graduated tax from 13.25 to 14.25 percent, with the excess profits tax?

Mr. MORGENTHAU. If you will, I will let Mr. Jackson answer that.

The CHAIRMAN. You have no views on that?

Mr. MORGENTHAU. I consider that an absolutely technical question. My training is such that I could not answer a technical question like that. I mean, we have got people who can talk for me.

The CHAIRMAN. We will ask Mr. Jackson. Now, as to the inheritance tax, and as to the exemption, does the exemption down to \$50,000 meet the administration's viewpoint?

Mr. MORGENTHAU. I cannot answer that.

The CHAIRMAN. Well, do you think that it carries out the suggestion in the President's message?

Mr. MORGENTHAU. Well, Senator, that gets right back to the question of my approving or disapproving what the House is proposing to do.

The CHAIRMAN. Let us get to the income tax. The surtax in the higher incomes, the President's message gives, for illustration, a million dollars; where we stop at a million dollars he desired to go up further and increase it to 75 percent in the higher brackets above the million dollars. The Ways and Means Committee began at a much less figure and has increased it below \$1,000,000 incomes, from 14 percent increase down. Does that meet the views of the Treasury Department, according to the message of the President?

Mr. MORGENTHAU. The Treasury has not, and as long as I am Secretary, is not going to have any views on how to write an income-tax bill. That, as I see it, is not my job.

The CHAIRMAN. I do not know of any Secretary of the Treasury that has not given to the Committee on Finance and the Committee on Ways and Means the views with reference to certain policies.

Mr. MORGENTHAU. Well, maybe I differ in many ways from previous Secretaries of the Treasury.

Senator KING. Mr. Secretary, you recognize the fallibility of your staff and the Treasury Department as well as the fallibility of the Congress. You conferred with the President, or made some suggestion to him, or at least your experts did. Whether Congress follows your recommendations made to the President, and his recommendations to the Congress, is quite immaterial to you, as I understand, because you think the responsibility rests upon Congress, after all, to determine the kind of revenue bill which will be enacted.

Mr. MORGENTHAU. That is what I think.

The CHAIRMAN. And it is your opinion that the administration would be satisfied with whatever kind of bill the Congress did enact?

Mr. MORGENTHAU. It would have to be satisfied.

The CHAIRMAN. It would have to be satisfied. But you are unwilling, as Secretary of the Treasury, to give to the committee your idea as to what the administration would best desire?

Mr. MORGENTHAU. Yes, sir.

The CHAIRMAN. In your letter to the Chairman of the Finance Committee on April 24, 1935, you suggested a certain procedure and a certain method with reference to inheritance taxes.

Mr. MORGENTHAU. I do not just happen to have the letter before me, sir.

The CHAIRMAN. Here is a copy of the letter.

Mr. MORGENTHAU. Thank you.

The CHAIRMAN. Now, will you give to the committee an explanation of just what you intended in that letter with reference to inheritance taxes?

Mr. MORGENTHAU. Well, Mr. Chairman, I appeared before this committee in connection with the bonus, and at that time I made the statement as to possible sources of revenue, and if I remember correctly, Senator La Follette asked that I be instructed to send up this letter, and I think it was the result of that request that this letter was written. May I read this letter?

The CHAIRMAN. Yes.

Mr. MORGENTHAU (reading):

DEAR SENATOR: In accordance with the committee's request during yesterday's hearing, I am glad to outline below a revenue measure which would provide funds for the payment of the soldier's bonus.

1. From the standpoint of immediate feasibility no less than that of our fundamental objectives, the best source of additional revenue at this juncture would be a system of taxes on the receipt of inheritances and gifts.

Such a system, supplementing our present estate and gift taxes, would fit in well with the rest of our Federal tax structure; would add to its balance and strength; and would not materially interfere with the present estate and gift taxes.

2. The program that is here suggested would be relatively simple to formulate and to administer; yet it would be effective. In brief, it is, with certain qualifications, to subject all inheritances and gifts to a system of rates similar to that of the Federal income-tax law.

3. The result of this proposal would be that gifts and inheritances would be taxed at progressive rates, and, under it, the Congress could provide for the effective rates to vary with the tax-paying capacity of the recipients of bequests and gifts. On very large bequests or gifts during a single year—\$1,000,000 or more—if the existing income-tax rates are applied, the total tax would approximate 60 percent.

4. To prevent the necessity for hasty liquidation of large properties in order to pay the tax, it might be provided that inheritance taxes be payable in a convenient number of installments.

5. The preliminary estimate is that such a tax would yield in 1936 approximately \$300,000,000 and might range upward to 600 millions annually. Our present estate tax is estimated to yield some \$190,000,000 in 1936. It may be observed that, from estate and inheritance taxes, England, with a population of approximately one-third that of the United States, and a smaller per capita wealth and income, collected more than \$400,000,000 in death duties in the fiscal year ended March 31, 1935.

The CHAIRMAN. Do you still make that suggestion to the committee?

Mr. MORGENTHAU. Mr. Chairman, that suggestion was made in connection with the bonus, and my opinion has not changed since that time.

Senator BARKLEY. In other words, you were asked to suggest to the committee the sources of revenue with which to pay the bonus?

Mr. MORGENTHAU. Yes, sir.

Senator BARKLEY. That question is not before us now.

Mr. MORGENTHAU. I think not.

Senator BARKLEY. I suppose, though, the same sort of rates, however, for general purposes would raise the same amount as it would for a bonus?

Mr. MORGENTHAU. This was a method of raising money to pay the bonus. The method still holds good.

Senator BARKLEY. I understand you did not suggest enough methods to raise the 2 billion dollars that would be required to pay the bonus.

Mr. MORGENTHAU. No, sir.

The CHAIRMAN. Now, I wanted to ask you with reference to that letter, Mr. Morgenthau. Will you explain to the committee the details of just how you would apply that inheritance tax to the rates on the present income tax?

Mr. MORGENTHAU. May I ask one of the Treasury experts to do that? I am not a tax expert.

The CHAIRMAN. Well, as I judge from this letter, what you intended to say was that the inheritance tax could begin to apply at \$2,000?

Mr. MORGENTHAU. May I have a minute, please?

Senator KING. Mr. Chairman, as I understand the Secretary, as I understand the letter, we asked for certain information and certain data, which was submitted. I do not understand that the Secretary, or his staff, inflexibly and irrevocably committed themselves to the levy of taxes and rates as indicated in that letter. I respect the views of the Secretary that he is not expected to tell us what kind of a tax bill to write.

The CHAIRMAN. But the Secretary did tell us how we could raise between \$300,000,000 and \$600,000,000, by levying a supplementary inheritance tax on the present income-tax rates.

Mr. MORGENTHAU. That is right.

The CHAIRMAN. We start the income tax rates, I think, on single persons at \$1,500.

Mr. PARKER. \$1,000.

The CHAIRMAN. \$1,000. So we would begin the inheritance tax on \$1,000, and carry it up according to the rates that are now in the present law, and in some instances the inheritance tax would increase the rate some 6,000 percent.

Senator KING. I assume the Secretary, in obtaining this information, relied upon the data which was submitted to him by the experts.

Senator BARKLEY. In other words, if such rates were adopted they would raise such an amount. The letter did not recommend that any such levy be made, because I understand the Treasury was not in favor of the payment of the bonus. These suggestions were based on the hypothesis that the bonus would be passed and every possible source of revenue would be required to be tapped in order to raise the money. I do not understand that that would have bound the committee to have adopted the rates if the bonus was passed and we would have been required to raise 2½ billion dollars.

Senator KING. I assume, Mr. Secretary, that neither you nor your experts are called upon to give your views as to the wisdom of any rates that would make it confiscatory of the estates or confiscatory of the property of the individual.

The CHAIRMAN. Would you not figure, if the bonus were up, or if we had to raise a sufficient amount of revenue, that this procedure outlined in your letter of imposing an inheritance tax should be according to the rates now fixed in the present law?

Mr. MORGENTHAU. Mr. Chairman, when I appeared before you gentlemen before, I said there were ways of raising the money. I was asked the question, "Will you suggest a method", and we suggested a method. Then I was asked, I think the following day, or shortly after that, to put it in a letter, and I wrote that letter in response to instructions from this committee to amplify what I had said. When I came here I simply said money could be raised, and I was asked the specific question how it could be raised, and I suggested this as a method.

The CHAIRMAN. In the imposition of an inheritance tax do you think the exemption ought to go down to \$1,000?

Mr. MORGENTHAU. That gets down to the question of statistics and rates, and we have our experts here who have made a life-long study of that and they can answer any statistical or rate question, I hope, that you ask them. I cannot answer.

The CHAIRMAN. Well, you have no views then with reference to where the inheritance or estate tax should begin.

We first had a \$100,000 exemption, then we reduced it down to \$50,000, and I think it is \$40,000 now.

Mr. PARKER. It is \$50,000 now.

The CHAIRMAN. In this letter you lower it to \$1,000; is that right?

Mr. MORGENTHAU. No, no. Do I say that in that letter?

The CHAIRMAN. Yes.

Mr. MORGENTHAU. To lower it to \$1,000?

The CHAIRMAN. No; but the present income-tax rates, Mr. Secretary, start on individuals that are not married at \$1,000. You propose in this letter to put in an inheritance tax on that \$1,000, in addition to the income tax rates now fixed by law. You increased it according to the graduated scale of the income-tax rate as it is now in the law.

Mr. MORGENTHAU. I do not understand, from this letter—I may be wrong—that I suggested where we start or stop.

The CHAIRMAN. Now, what did you intend to do in that letter, then?

Mr. MORGENTHAU. Just what I said, sir; no more and no less.

Senator GORE. Read the paragraph you have in mind, Mr. Chairman.

Senator BARKLEY. I understand the letter was intended to state how much money could be raised from certain taxes. Whether the Secretary then or now would state that he was in favor of lowering the exemption to \$1,000 is not very material, because if every expert in the Treasury recommended it I would not vote for it.

The CHAIRMAN. Well, I would not, either.

Senator BARKLEY. But I do not think we ought to require them to take the position as to what our policy should be as to what rates should be levied, or where we should begin or leave off.

The CHAIRMAN (reading):

The result of this proposal would be that gifts and inheritance would be taxed at progressive rates and, under it, the Congress could provide for the effective rates to vary with the tax-paying capacity of the recipients of bequests and gifts. On the very large bequests or gifts during a single year—\$1,000,000 or more—if the existing income tax rates are applied, the total tax would approximate 60 percent.

To prevent the necessity for hasty liquidation of large properties in order to pay the tax, it might be provided that inheritance taxes be payable in a convenient number of installments.

Then you give the preliminary estimates of \$300,000,000 and \$600,000,000. Was it a fair construction to put upon this proposition that you intended to start and supplement the present income-tax rates by imposing an inheritance tax on all of this?

Mr. MORGENTHAU. Mr. Senator, the very fact we make an allowance from \$300,000,000 to \$600,000,000 I would say indicates clearly that we leave it up to Congress to say where the thing should start

and stop. If we work it out as to a definite exemption and definite rates, we would give you an exact figure, but we gave you an upper and lower limit, feeling Congress should say what the upper and lower limit should be.

The CHAIRMAN. Let us apply it on a \$50,000 exemption. What would be the estimate then, according to the suggestion made in this letter, if we were to raise any revenue?

Mr. MORGENTHAU. Can one of the experts answer that?

The CHAIRMAN. Yes.

Mr. MORGENTHAU. Mr. Haas.

Mr. HAAS. The Ways and Means Committee submitted to the Treasury various schedules which embodied this principle as outlined in the Secretary's letter to the Chairman of the Finance Committee, and asked the Treasury to submit estimates on the schedules. I might read the statement which was submitted by the Treasury to the Ways and Means Committee.

D. Tables 11 and 12 embody the proposal of taxing the combined inheritance or gift and statutory net income at present income-tax rates, with a deduction of the tax paid on the statutory net income. Thus, in effect, all inheritances and gifts received by an individual in any year would be treated as ordinary income and subjected to the individual income-tax rates. The effective rate of the inheritance or gift tax would therefore vary directly with the accumulated wealth and earning power of the recipient, as measured by his income.

The average income of several years, rather than the income of a single year, may be used.

(a) If no exemptions are provided for, such a tax is estimated to yield \$678,000,000 in additional revenues.

(b) If a tax credit of \$9,700 be allowed for each recipient, thereby freeing all inheritances and gifts of \$50,000 or less from any tax, and likewise reducing the tax on all larger amounts by \$9,700, this proposal is estimated to yield \$472,000,000 in revenue.

(c) If a tax credit of \$9,700 be allowed each recipient of inheritance or gift of \$100,000 or less, thereby freeing all inheritances and gifts of \$50,000 or less from any tax, but not allowing this tax credit in connection with amounts larger than \$100,000 the estimated revenue is \$503,000,000.

The CHAIRMAN. Mr. Secretary, in the House bill they have about 10 years in which to pay this inheritance tax. It is 10 years, isn't it?

Mr. PARKER. Ten years.

The CHAIRMAN. And the rate of interest is 3 percent for a certain number of years.

Mr. PARKER. The first 3 years.

The CHAIRMAN. The first 3 years 3 percent, and then after that 6 percent. Do you think that is a long enough time to wait on the proposition?

Mr. MORGENTHAU. May I have a minute, please? I am informed in Mr. Jackson's statement he covers that particular field in great detail. Now, if you would like him to read from that particular part now he would be glad to do so, whatever you wish.

The CHAIRMAN. It is your belief that in these large inheritances, where a large rate is imposed upon the estates, and then a still larger rate imposed upon the inheritance, that there ought to be liberality manifested by the Treasury in permitting these estates that have their investments, in large part, in going concerns, so that they can refinance themselves through banks or otherwise, but that a lien be imposed upon them?

Mr. MORGENTHAU. May I have a minute, please? I would say that the Treasury's position is that we favor a liberal policy. As to

the details, why we would be glad to tell you what policy we have and are now following in regard to this matter.

The CHAIRMAN. What is the policy that you are now following?

Mr. MORGENTHAU. Mr. Jackson will answer that.

Mr. JACKSON. Well, I have the detailed statistics as to just the number of extensions that are applied for, the number of extensions that are granted.

The CHAIRMAN. That is on the present estate tax?

Mr. JACKSON. That is on the present estate tax, but it is some measure, of course, of the difficulty that is now experienced. All of that appears in the statement which I will make to you later, unless you prefer to go into it by sections. Just as you prefer, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, may I ask you, if there were a lien—of course, the lien is imposed now on the estate tax until it is paid. That is right, isn't it?

Mr. MORGENTHAU. Yes.

The CHAIRMAN. If a lien is imposed upon this inheritance tax, this large amount that we seek to impose here, do you see any difficulties in a person who inherits a large amount, who has his money invested in a going concern, whether it is an automobile plant or whatnot, in refinancing his organization or getting money from banks if the Government is going to put a lien upon his property?

Mr. MORGENTHAU. Just a moment, please. Mr. Chairman, that would depend upon the composition of the estates, and Mr. Jackson here has an analysis of cases which we have handled and which are now pending before the Bureau, and he can either go into it now or he can go into it when he reaches it in the statement.

The CHAIRMAN. Were all of these details discussed before the message came to Congress?

Mr. MORGENTHAU. No.

The CHAIRMAN. What is that?

Mr. MORGENTHAU. No.

The CHAIRMAN. There was no consideration given by the Treasury to these details before the message came to Congress?

Mr. MORGENTHAU. I withdraw that answer. The Treasury is constantly making studies in relation to taxes, and there is not a day passes that we haven't got people that constantly study that subject. I hope that the Treasury's staff is able enough, that they have covered all possible features of taxation, and they are constantly doing it. That is what our job is.

Senator KING. Different questions arise, new factors are introduced in business and into the Treasury's calculations, and into our economic life every day.

Mr. MORGENTHAU. Last summer we sent some people, and you sent several to England for 2 or 3 months to bring ourselves up to date, and those kinds of research studies are constantly going on.

Senator GORE. Did they submit any report on their investigation?

Mr. MORGENTHAU. Yes, sir.

Senator GORE. Has that been submitted?

Mr. MORGENTHAU. Yes, sir.

Senator GORE. Printed in our hearings?

Senator KING. Printed in pamphlet form. I have two at my office.

Senator COSTIGAN. Were these continuing studies of the Treasury available to the President at the time of the message?

Mr. MORGENTHAU. Anything that the Treasury has is always available to the President.

Senator BARKLEY. Now, as I understand it, talking about the lien, there is a lien at present on the estate that is taxed for the collection of the tax, and they have at this time 5 years to pay—or what is it?

Senator KING. Eight years.

Senator BARKLEY. Eight years, in which to pay. It is proposed here, in this legislation, to give 15 years, I believe.

The CHAIRMAN. Ten.

Senator BARKLEY. Our suggestion was 12 when we were talking about it before. This House bill proposes 10?

The CHAIRMAN. Ten.

Senator BARKLEY. I suppose that is subject to change also by the Senate, but is there anybody, whether he is the Secretary of the Treasury, or tax expert, or Senator, able to tell whether any particular estate would have difficulty in borrowing money from a bank, giving a mortgage on the property on which the Government has a lien?

Mr. MORGENTHAU. All I can say, Senator, is that we have this analysis, and I would be very glad to have Mr. Jackson give it to you now. That touches right on that point.

Senator BARKLEY. Does anybody propose that the Government retain no lien on these estates, or the inheritances, outside of that proposed to collect this tax?

Mr. MORGENTHAU. Are you asking me that question?

Senator BARKLEY. Yes.

Mr. MORGENTHAU. Mr. Chairman, may Mr. Jackson answer?

The CHAIRMAN. Yes.

Senator BARKLEY. I say there is no lien in the sense that the city has a lien on a piece of property for street improvements, so it is recorded at the courthouse and gives notice to all the public that there is such a lien for any unpaid assessments, but in a general sense the Government has a prior claim of a general nature against estates for the collection of this tax?

Mr. JACKSON. That is right, Senator Barkley.

Senator BARKLEY. It would naturally be carried along on any inheritance tax, the same sort of obligation.

Mr. JACKSON. But it can be made a lien.

Senator BARKLEY. It can be made a lien by taking certain steps?

Mr. JACKSON. On specific estates.

Senator BARKLEY. On particular property. So it would be a matter of public record?

Mr. JACKSON. That is right.

Senator BARKLEY. Anybody who bought that property or accepted a mortgage on it would have notice that the lien would attach to that particular property. But in the absence of that procedure it is just in the nature of a general claim against the estate by the Government for the collection of tax.

Mr. JACKSON. The executor is free to liquidate according to his own wishes.

Senator BARKLEY. Yes.

Senator KING. It seems to me very clear that it would be almost impossible for any bank, or any number of banks, to give credit, make a loan of several millions of dollars to aid the person who was the beneficiary of a decedent's gift of an estate to liquidate the indebted-

ness where the property consists of stocks, bonds, and real-estate properties in a half dozen States; it is impossible to go to the bank and get sufficient funds to liquidate the tax. It seems to me that that is obvious. The bankers have got to exercise some prudence. They have got to guard and protect the intrests of their depositors, and the bank would be very foolish to loan two or three million dollars on an estate for the purpose of meeting the tax, where the estate consists of various kinds of stocks and bonds and property, and so on, scattered around in half a dozen States.

Mr. JACKSON. It depends entirely on the composition of the individual estates.

Senator KING. Absolutely. So there ought to be a liberal policy provided to meet those situations, because if you force liquidation, force the payment of the tax, you are going to destroy the estates, and you are going to confiscate the property that is supposed to be inherited by the heirs of the deceased.

Senator BARKLEY. You cannot lay down any ironclad rules by which all estates or all inheritances of estates can be governed in the collection of these taxes. That is one problem that confronts us.

Mr. JACKSON. We make a great many extensions, a great many compromises. Both the extension power and compromise power are exerted in connection with estates that have difficulties in liquidation. Some estates could not liquidate if they did not have a nickel of tax to pay because of the involvements of debt. Other estates have tax-exempt securities far and away above the tax, and they have no difficulty at all. Now, our study shows 55 percent of the average estate is in securities, and debts are 14 percent of the gross assets. So that the general run of estates, if you legislate for the generality instead of the particularity of the estates, are not particularly embarrassed.

Senator COSTIGAN. What is the average percentage in real estate?

Mr. JACKSON. The average percentage in real estate is 19.1 percent; in securities, 53 percent; in mortgages, cash, and insurance, 22 percent; miscellaneous, 5 percent; and the debts average a ratio of 14 percent in 1932 and 17 percent in 1933. Those are the latest figures we have.

Senator BYRD. How about the tax-exempt securities? Have you got them separately?

Mr. JACKSON. No; it is not segregated, Senator Byrd. The average number of extensions granted has ranged from 1 percent and 0.22 in 1929 to 2.16 in 1935.

Senator GORE. What item was that?

Mr. JACKSON. That is the number of extensions by the Commissioner to enable delay in liquidation, and it runs from 1 percent to 2.16 percent.

Senator GERRY. Under this bill, where you combine the estate and inheritance tax at the end of 5 years, the interest running against the estate would be 12 percent, would it not, annually?

Mr. JACKSON. I think that is the provision of the present House bill.

Senator GERRY. That is the provision of the present House bill, as I understand it.

Senator LONERGAN. Mr. Chairman, may I ask a question?

The CHAIRMAN. Go ahead.

Senator LONERGAN. Mr. Secretary, let us take the case of an individual manufacturer who has established a large business, and who owns the business, and we will say that the business is worth \$500,000. This estate is represented by factory buildings, by machinery, by the unfinished product, by the finished products, and certain cash in the bank. He dies and he has an heir. How would the Government proceed to collect the inheritance tax in a case like that?

Mr. MORGENTHAU. May Mr. Jackson answer that?

The CHAIRMAN. Yes.

Mr. JACKSON. I do not think the case cited gives adequate information to determine the question. If that business, worth \$500,000, is not involved in debt, it then becomes a comparatively simple matter to raise money on it, provided it has earnings. All of those elements which go into the determination of a banker's risk enter into the question of how easily that tax could be paid.

If, on the other hand, you assume that it has involvements in debt, that it owes a bond issue of one-third of its assets to one-half of its assets, and that it has a floating debt as much as the banks would permit, then you have a real problem on hand and you would have to sit down with the executors and work on the question of extension, and you might even work to compromise, as we do every day in connection with the estates which are involved.

It is absolutely impossible to lay down any rule, Senator, for the liquidation of estates until you know the ratio of debts to quick assets, and if your quick assets are all involved in one business then you have got to look to the balance sheet of the business.

Senator LONERGAN. I think I have made myself clear. I have cited a case. I know a great many now with the tax running against the estate, the inheritance tax and the estate tax, where the tax would be, under the House bill, \$440,000,000. I want to know how the \$440,000,000 could be raised without destroying that industry.

Mr. JACKSON. Of course there are many ways that the executors would presumably work it out.

Senator LONERGAN. Tell me one way, will you?

Mr. JACKSON. Yes. You have assumed that he owns the entire business?

Senator LONERGAN. Yes, sir, free of debt.

Mr. JACKSON. Free of debt. Then I assume the first logical step would be to raise money on the business by way of a bond issue.

Senator LONERGAN. Tell me how it could be done.

Mr. JACKSON. If I had to do it I would go to a good banker and take his suggestion. I think there would be plenty of people glad to underwrite the bond issue on the example you have in mind, Senator.

Senator LONERGAN. You mean he would underwrite the \$440,000,000 on an estate of \$500,000,000?

Senator GORE. An individual or corporate estate?

Senator LONERGAN. Yes, sir; an individual estate.

Mr. JACKSON. You do not ordinarily find that all of the assets of persons in those situations are involved in that business. There are a lot of other assets to which resort can be had.

Senator LONERGAN. I am assuming that there are not any other assets, that the entire estate is represented by the business. How can the Government proceed without destroying the business?

Mr. JACKSON. I think if we are dealing with the same example that in 10 years' earnings you would pretty well take care of it, Senator. We could give a 10-year extension under the bill, as I understand it, and we would not be under the necessity of closing out that business.

Senator LONERGAN. Yes; but death has removed the genius of the business, the directing hand of the business. What is your answer to that?

Mr. JACKSON. If that is true, then the business is not worth that amount of money, if it depends on the genius of one man who passes out.

Senator LONERGAN. Isn't it true that it would result in the destruction of that business?

Mr. JACKSON. Not at all. I do not see any reason for it at all.

Senator LONERGAN. Give me a reason why it would not.

Mr. JACKSON. Because I think business that is established as well as that business is, built up as quickly as that has, there are a considerable number of interests in the United States that would be glad to purchase it and go on with it, and to supply genius.

Senator LONERGAN. Now you are a lawyer of experience. Is not this true: Have you ever seen a business that was put on the market through a forced sale that ever sold for more than 10 or 20 cents on the dollar?

Mr. JACKSON. Oh, yes. It would not go into such low percentages. It depends on the force you had to use. If you had to liquidate it within 6 months or a year, that is one thing. If you had 10 years, that is quite a different thing. Of course we have seen estates wiped out, we have seen estates report a very nice net estate and have seen them wiped out before the executors could liquidate them in 1929, but that is not a normal condition and you cannot shape legislation to take care of such abnormalities.

Senator LONERGAN. I think in the case I have cited it would result in the destruction of the business. The genius would be removed, the business would be offered and it would be sold to the high bidder, and a large number of persons would lose their employment.

The CHAIRMAN. Are there any other questions of Secretary Morgenthau? The reason I am asking, Mr. Newton D. Baker is here and I want to take him on this morning so he can get away. We will finish with Mr. Morgenthau, the Secretary.

Senator GORE. I would like to ask Mr. Jackson one question. He said the earnings of the concern would pay the taxes. As I understood him a moment ago, he said at the end of 5 years the interest would be 12 percent. That would absorb a good deal of the earnings, wouldn't it?

Mr. JACKSON. I do not want to say the earnings would pay the taxes, I do want to say the earnings on that particular business, if the past is any indication, would wipe out the tax problem.

Senator GORE. If you take \$460,000,000, paying 12 percent on that would be a good deal.

Mr. JACKSON. I have never been committed to the view that we ought to have a 12 percent interest on any indebtedness which arises involuntarily.

Senator GORE. Yes. I am glad to get that in the record.

Senator BARKLEY. The Senate passed a bill the other day reducing the interest on inheritances to 6 percent.

Mr. JACKSON. Twelve-percent interest is a pretty high rate of interest.

Senator LA FOLLETTE. Mr. Chairman, may I suggest that we have a much more orderly procedure, and then Mr. Jackson can answer the questions more intelligently, otherwise we will have to go over this again and again.

The CHAIRMAN. I wanted to finish with the Secretary himself. We will take Mr. Jackson on later.

Senator LONERGAN. Mr. Chairman, may I ask the Secretary one question?

The CHAIRMAN. Yes.

Senator LONERGAN. Mr. Secretary, what is the policy of the Treasury Department in reference to tax-exempt securities?

Mr. MORGENTHAU. Last year, I think it was before this committee, I am not sure, I appeared before Congress anyway, and recommended a constitutional amendment making it possible to do away with that exemption.

Senator LONERGAN. Is that the policy of the Treasury Department now? Would you like to have Congress proceed along that line?

Mr. MORGENTHAU. I haven't changed my opinion since last year.

Senator LONERGAN. And that is true of the administration?

Mr. MORGENTHAU. I think so; yes.

The CHAIRMAN. Are there any other questions?

Senator BARKLEY. This matter on which the Treasury Department has a policy, everybody has his own individual views about that. The Secretary of the Treasury has expressed his in the President's message, in the President's recommendation.

Senator GORE. I want to ask the Secretary a question or two. I want to get the Secretary to elaborate his suggestion that the revenues derived under this bill could be applied to the payment of the deficit, or to taking care of the debt. I am impressed with that suggestion. I would like to have you elaborate that point just a moment, as to the mechanics of it, as to what should be included in this bill in order to carry out your suggestion.

Senator KING. Senator, you do not believe, do you, that \$270,000,000, or even \$300,000,000 is going to go a very long way in meeting the deficit and paying the deficit which now is practically \$30,000,000,000?

Senator GORE. As a matter of mathematics, I do not. I would like to see the vast expenditures curtailed so we can get closer to bringing that about, but the Secretary volunteered the suggestion and I would like to have him elaborate it.

Senator BARKLEY. I presume the Secretary did not want to volunteer the suggestion that \$300,000,000 would be applied on this deficit. I understood, as far as it goes, it could be applied either to the reduction of outstanding debts or it could be applied toward the current expenditures.

Senator GORE. I drew some inference of that sort myself, but if the Senators do not object I would like to have the Secretary elaborate on it.

Mr. MORGENTHAU. Senator, I am not quite sure that I have your question clear.

Senator GORE. You say that the revenue derived on this bill is supposed to be applied to the deficits and not used in the general revenues of the Government?

The CHAIRMAN. He said, Senator Gore, it was to be applied first to reduce the deficit and later to reduce the public debt.

Senator GORE. Yes.

The CHAIRMAN. What part would you apply to reducing the debt and what part to reducing the deficit?

Senator GORE. Understand, I am in accord with your suggestion, but I want to get the details.

Mr. MORGENTHAU. As to the mechanics, if this bill is passed by Congress and it provides millions of dollars additional revenue, the mechanics of it would be, first, we would have to borrow that much less money.

Senator GORE. Yes.

Mr. MORGENTHAU. And then as we approach a balanced budget why, we could gradually apply that to the sinking fund, reducing our national debt.

Senator BYRD. What do you estimate the deficit for the current fiscal year, Mr. Morgenthau?

Mr. MORGENTHAU. Senator Byrd, the President, in his message to to Congress, has estimated 4 billion dollars.

Senator BYRD. This would derive revenue for about 7 percent of the deficit?

Mr. MORGENTHAU. You are referring to the House bill?

Senator BYRD. Yes.

Mr. MORGENTHAU. Yes, sir.

Senator BYRD. The bill before the committee.

Senator GORE. Then for the present, Mr. Secretary, you just let the revenues come in to the general fund and they are to be applied to the extraordinary expenses and the ordinary expenses?

Mr. MORGENTHAU. It would just mean, Senator, we would have to borrow that much less.

Senator GORE. That is the only point you have in mind?

Mr. MORGENTHAU. That is the only point I have in mind.

Senator BARKLEY. These revenues go into the general fund, they are appropriated by Congress, like other funds?

Mr. MORGENTHAU. Yes, sir.

The CHAIRMAN. Would you go beyond applying the inheritance and gift taxes to the reduction of the national debt?

Mr. MORGENTHAU. In my suggestion that I made, I think, before the Ways and Means Committee, I suggested that would be used for that purpose.

The CHAIRMAN. The reason why I am asking, the President, in his message, suggested that only the inheritance and the gift taxes be applied to the reduction of the national debt. I was wondering if you were in accord with that, or whether you thought it ought to be broadened to apply all of the taxes that we raised under this bill?

Mr. MORGENTHAU. May I refer to a sentence which I read before the Ways and Means Committee? I said this. This is very short, it is a paragraph, if I may read it. I think it covers what Senator Gore has in mind.

The Treasury's first concern is with the adequacy of the national revenue. There are times of emergency where the Treasury must finance expenditures in

excess of income by borrowings, which increase the public debt, but the national welfare demands when such emergency is passed sufficient income be raised both to meet current expenditures and to make substantial reductions in the debt. The time has come to move in that direction. It would, of course, be unwise to impose tax burdens which retard recovery, but it would be equally unwise not to call on sources of revenue which would reduce our borrowings and later reduce the national debt without recovery. It is my belief that the additional taxes which the President now recommends fall within this clause.

Senator KING. In other words, all the taxes that come under this bill reduce the borrowings, and to that extent they do not decrease the national debt, they simply prevent us from increasing the national debt.

Mr. MORGENTHAU. They do not decrease the national debt until the Budget is balanced, then it goes to the reduction of the national debt.

Senator BARKLEY. While the President's message indicated the deficit of \$4,000,000,000, I gather from the public press that it would actually be less. Is that a fair assumption or not?

Mr. MORGENTHAU. I would not want to make any forecast. It is too difficult, Senator. I cannot answer that, it is just too difficult.

Senator BARKLEY. I do not know whether these publications are accurate or not.

Mr. MORGENTHAU. We were fortunate last year in that our estimates for revenue were low and our estimates for expenditures were high, but whether that will be so this year, I do not know.

Senator GORE. Mr. Secretary, I would like to ask this question. This revenue is proposed to take care of the deficit to the extent of 7 percent only. Do you think that is sufficient? Should we not have more revenue than that?

Mr. MORGENTHAU. Senator, that would get back to the original question of my discussing the bill pending before the House.

Senator GORE. You think, as the Secretary of the Treasury, that from the standpoint of the Public Treasury, by taking care of the deficit to the extent of 7 percent, that is all that should be done?

Mr. MORGENTHAU. Well, it would be relieved just 7 percent.

Senator GORE. There is one other question. I notice in the morning paper the President said there was a great deal of tax avoidance and evasion, and mentioned one estate where some 90-odd trusts have been established under which there was tax evasion. If you care to discuss that point I would like to hear it. I would like to have you submit some specific recommendations as to how that thing can be stopped.

Mr. MORGENTHAU. Senator Gore, that is gone into in considerable detail by Mr. Jackson in his statement.

Senator GORE. Very well.

The CHAIRMAN. Are there any other questions? Thank you, Mr. Secretary. Secretary Baker.

STATEMENT OF NEWTON D. BAKER, CLEVELAND, OHIO, REPRESENTING 10 ORGANIZATIONS, NATIONAL AND REGIONAL

Mr. BAKER. Senator Harrison, I am here at the request of 10 organizations, national and regional, to say a word in behalf of the proposed exemption of gifts by corporations to charitable undertakings from income taxes. I have a list of the organizations in whose behalf I am here.

1935 Mobilization for Human Needs; Gerard Swops, chairman. (Union of 35 leading national welfare organizations to reinforce local fund-raising effort administered by)—

Community Chests and Councils, Inc.; Frederick R. Kellogg, president (New York City).

National Conference of Catholic Charities; Msgr. R. Marcellus Wagner, president (Cincinnati).

National Council of Young Men's Christian Associations; Frederick W. Smith, president (Newark, N. J.).

National Council of Jewish Federations; William J. Shroder, president (Cincinnati).

American Hospital Association; Mr. Robert Jolly, president (Houston, Tex.). (Most local branches of these national organizations are supported by local community chests.)

United Hospital Fund of New York; D. H. McA. Pyle, president.

Federation for the Support of Jewish Philanthropists of New York City; S. D. Leidersdorf, president.

Citizens' Family Welfare Committee of New York; James G. Blaine, chairman.

Catholic Charities of the Archdiocese of New York; Patrick Cardinal Hayes, president.

I do not want to take an unnecessary moment of the committee's time, Mr. Chairman, and for that reason perhaps it would be wiser for me to make a very brief preliminary statement and then subject myself to any questions that there are and let the committee dispose of me quickly.

The CHAIRMAN. Very well.

Mr. BAKER. The problem is, of course, a national problem. My contact with it is pretty nearly lifelong. I have been a trustee or other responsible but unpaid executive of hospitals and educational institutions, and charitable undertakings all my life. When the war came we found the necessity for united drives for the support of social services for the Army.

I hope the committee will permit me to say, because I like to say it, that American Army in the World War was the first Army in the history of the world ever to be provided with the social services of its home while it was campaigning in the field. We followed the American soldier into battle with his home influences, and the consequence was that expert opinion pronounced the American Army in France sanest, soberest, and most moral body of men of like number ever assembled on the planet. That came from the fact that recreational opportunities, entertainment facilities were supplied to these men away from home, and the usual indulgences which the soldier's idle time are resorted to were unnecessary in that instance. In order that the Young Men's Christian Association, the Catholic group, the Jewish group, the Salvation Army and those organized by the Army itself in its recreational activities could thus follow the soldiers it was necessary that there should be an appeal to the private philanthropy of the American people.

That led to what we called united drives, in which the first \$100,000,000 was secured, and later \$200,000,000 to supply these facilities. When the war was over a very great man, the greatest philanthropist with possibly one exception that Cleveland has ever had, Mr. Samuel Mather—I knew him for 30 years and I never knew his philanthropies to be less than a million dollars a year during my lifetime, and he died practically solvent—suggested that the experience of the Nation in thus unifying the support of its charitable and philanthropic undertakings certainly ought to be followed in Cleveland as a city.

and so there was established there what we call the community fund. It has been widely copied all over the United States in the cities.

The theory of it is that the need for social services is distinctly a product of city life, and particularly the life of industrial cities, and that by unifying the appeal and supervising the expenditure great economies are secured, duplications are avoided, time is not wasted by those who are employed to extend social services in campaigning for funds.

Cleveland still raises from $3\frac{1}{2}$ to 5 million dollars every year, and out of that fund are supported its hospitals, its playgrounds, its character-building institutions and its relief agencies of one sort or another.

Now the fact about America is that, apart from certain great coastal ports of entry and certain interior distributing stations, the cities of the United States are the child or children of the industries of the United States. Our cities have been built by our industries and all over the United States you can find cities which are merely the residences, congested, uncomfortable, and with the limitations of city life of the persons who are employed primarily in one industry.

Schenectady, N. Y., for instance, is the principal home of the employees of the principal manufacturing department of the General Electric Co. Bethlehem, Pa., is the principal home of the employees of the Bethlehem Steel Corporation. I might give a thousand illustrations of that sort, where the only employer practically that the city has is a single industry.

Now the people who are employed in those factories are just like any other people, and when they are city people their needs for social services are accentuated. They have to be hospitalized. Not the employees only, but their families and their dependents who live with them. We employ their women in the factories in one sort of employment or another. So take the mother out of the home and put the children on the streets of congested cities, and if character is to be built at all in the younger generation, with the influence of the father and mother partially withdrawn, the needs for character-building agencies in our cities is a part of the social structure of modern American industrial life. That has so far now come to be recognized that everybody who lives in an industrial city recognizes that being a good neighbor means that according to their means they must contribute to the centralized fund, assured of the wisdom and economy of its distribution and use, and its application to their needs.

Now it is an interesting observation to make, if the committee please, that in the city of Cleveland, which is half and half an industrial city, only about half of the supposed 25 percent of the community fund subscriptions come from industrial corporations, and in a very careful survey that was made among the employees of those industries it was found that from one end to the other of the year 38 percent of the employees of those industries were in some way ministered to by one of the agencies supported by the community fund. Their wives, their children were hospitalized or went to the dispensaries or dental clinics, or they were taken off the streets in the playgrounds philanthropically and medically. They were cared for, and visiting nurses went up to their houses, or anyone of a dozen of these alleviations of congested city life were supplied to them through the agencies maintained by this fund.

Now I have been for 3 years the general campaign chairman of the National Mobilization for Human Needs. The object of that has been to teach, if possible, to the people of the United States the importance of the maintenance of these social services. I am the chairman of the executive committee of the Cleveland fund, and each year I spend 10 days in the city itself, abandoning everything else, devoting it to this objective.

Those activities have led me to realize the importance of corporation contributions. Taking it by and large, the community chests of the country, plus other welfare appeals raised about \$200,000,000, of which from 20 to 25 percent is contributed by corporations, and perhaps another 20 or 25 percent by the employees of the corporations, and the residue by the business men associated with these corporate undertakings, having stores or places of business which minister to them.

I deeply believe that the corporation has not only a right but a duty to be a good neighbor in the town in which its own employees live, and that there are obvious and direct benefits going to a corporation which makes a subscription within modest limits to a fund of this sort, and an incalculably valuable and direct benefit by virtue of the fact that the tailings, the inescapable losses due to an industrial organization are minimized, and the next generation which is coming along that must supply the labor for the industries has a higher character, it has a finer outlook on life, it is a better class of labor, that is just in preparation for the factory door by virtue of the application of these social services to the younger generation around the mill location.

Now, I do not know that there is anything more for me to say except that in something like 20 or 22 States of the Union laws have been passed by the legislature authorizing corporations to make such contributions as a part of their proper corporation expenditures. That is true in the great State of New York. It is true in Ohio. It is true in practically all of the industrial States. It seems to me a very wise provision.

It enables the corporation to provide an example, in the first place, to its own employees, and others, and to bear its part as a good neighbor in the town which it has made and which depends on it for its maintenance. Frankly, I do not believe that the corporate form of business has a right to be exempted, either by the public or by law from its duty to be a good neighbor. If the corporations could shield themselves behind the fact that there was a disapproval of their contributions for this purpose, then private business undertakings, individuals, and partnerships, would be at a very grave disadvantage, because the corporation would say, "Well, we can, but the private owner of a business would recognize that he must," and so the corporation would be given an advantage over private business, which I think it is not entitled to.

Now I think if the corporation is permitted, within modest limits, and the bills which are before the Government limit the provision to 5 percent, and many of the State laws are even 1 or 2 percent, but I think when there is a prudential limit upon the extent to which the charitable undertakings can be supported by corporations, that they ought to have the corresponding advantage of exempting them from the income taxes, just as they now are, so as to place the two forms of business on a parity in this matter.

I shall be glad to answer any questions that the Senators have.

Senator BARKLEY. Secretary, I value the views you have on this. Of course the corporations are owned by stockholders and the income of the corporation is their property.

I have been wondering whether any board of directors or officers of a corporation have a legal right or a moral right, regardless of the high purpose of the contribution, to take a part of the net earnings of their stockholders for even charitable purposes without the consent of the stockholders.

Mr. BAKER. Well, Senator Barkley, the legal question is perhaps difficult only because it has not been frequently decided. The moral question seems to me quite simple and clear. A corporation's board of directors have the right and the duty to do with the assets of that corporation the things which in their honest discretion must advance its interests. Now, if in the judgment of the board of directors a contribution toward a community hospital in which the families of its employees can get emergency relief creates a better labor situation, a better public state of mind, and that is done within narrow limits, and conscientiously done, I think no court would deny that they had a right to do that.

So far as the stockholders are concerned, and on the moral question, I haven't the least doubt that the duty of the directors is to do what they think the stockholders would do if they faced the duty as an individual, and when they look at it from that point of view, any stockholder who ran the business as his own business and did not contribute to the community need would be a bad neighbor in that community and would have difficulty in keeping his business going.

Senator BARKLEY. So that there is a material advantage that accrues to the corporation by the charitable donation?

Mr. BAKER. There are direct advantages, Senator. Many of the corporations, for instance, in their community fund contributions, specify that they are to go to particular things, to the service which is more obviously and directly for the benefit of the undertaking, as, for instance, special hospital services to the employees. That is direct. Instead of running a hospital of their own, they make a contribution to the community fund and stipulate that that is to go toward the maintenance of hospitals in the neighborhood of their plant, but it goes through the community fund and gets the appearance of the community fund contribution. There the benefit is direct, but in many instances the indirect benefits are probably even in excess of the direct.

Senator BARKLEY. And that raises the question whether any expenditure ought to be exempt from an income tax which results in a benefit to the corporation making it.

Mr. BAKER. Well, undoubtedly, Senator, it ought to be exempt. There are two ways of regarding it. One is to regard it as a matter of corporation accounting, as an expense of operation. Now the State laws on that subject authorize corporations to treat these as legitimate expenses in the operation of their corporate undertakings.

The question of exemption from taxation is a question of Federal policy rather than a State corporation policy.

Senator BARKLEY. Well, from your experience and observation, are you able to estimate on the average the percentage of net incomes donated by corporations to charitable purposes?

Mr. BAKER. Senator, it is fractional, it is relatively insignificant.

Senator BARKLEY. It is not on the average more than 1 percent?

Mr. BAKER. Oh, no.

Senator COSTIGAN. Secretary Baker, is there any reason why the corporations to which you refer should not make contributions in addition to their normal tax burden? In other words, is there any reason why corporations should not promote goodwill for social purposes in the community after meeting their tax burden?

Mr. BAKER. Well, I do not suppose there is any particular reason, Senator. I am not representing any corporations. I hope the committee understands that what I am trying to do is to get the help of the Senate to make corporations contribute. I think they ought to contribute. I want them induced to contribute by giving them the same opportunity that you give the private individual.

Senator COSTIGAN. You of course recognize the necessity for Federal contribution to States and perhaps communities for relief under modern industrial conditions, especially those we have been assisting in the present emergency. You are not opposed to State aid for purposes of relief, I assume?

Mr. BAKER. Well, I regret the necessity, Senator.

Senator KING. Yes.

Senator COSTIGAN. If such necessity exists where would you draw the line between such contributions to States by the Federal Government and the philanthropic activities to which you have very properly referred?

Mr. BAKER. I think the philanthropic activity is distinctly a local service, and that the State aid that you speak of has been and unquestionably ought to be restricted to material relief growing out of disastrous economic conditions.

Senator COSTIGAN. Are you satisfied that community chests, the Red Cross, and other agencies that are maintained, in whole or in part, through private contributions, with such tax exemption as you favor, will be able to meet the needs of our industrial cities?

Mr. BAKER. No, Senator; I am far from satisfied. However, I think that the hope of the Federal Government retiring from this emergency activity is improved if we can increase the likelihood of local people bearing the burden which the Federal Government will relinquish to it.

Senator BARKLEY. Mr. Secretary, has there been any appreciable diminution in the contributions made by corporations to charity funds on account of the Federal activities in the granting of relief?

Mr. BAKER. Senator Barkley, I cannot follow that through. Last year and the year before the greatest difficulty we had, as the National Mobilization for Human Welfare Committee, was to persuade the well-disposed people of the United States that the need still existed, in spite of the Federal-State aid business. Now what we did was to go to every community and by radio addresses, Nation-wide, and with the voice of the President and others, we pointed out that all that the Federal Government was doing was taking care of the purely material need, that it was not supporting the hospitals, that it was not supporting the character-building agencies, and that in times of depression, when there was unemployment, the need for these hospitals and for character-building agencies was increased rather than diminished. Now as the result of perfectly tremendous efforts,

joined in by national agencies of every kind, we did succeed in raising practically the budget of the community chests last year, but we constantly faced the difficulty of people saying, "Well, the Government is doing it, why should I take any of it?" And those who were too impatient to hear the answer rested in that belief.

Senator GORE. Mr. Secretary, is it your belief that the social service as outlined by these charities is incident to our civilization?

Mr. BAKER. It is absolutely incident, as civilization is understood and administered, it is absolutely incident.

Senator GORE. If the corporation is prohibited from making any contributions then the means must be found from some other quarter?

Mr. BAKER. Yes, sir.

Senator GORE. Either by some other private contributor or by the Government?

Mr. BAKER. Yes, Senator Gore.

Senator GORE. Do you think other private contributors would supply the required recharges?

Mr. BAKER. No, sir. I think the difficulty of making up the 25 percent now contributed by corporations from private sources would be so great that practically every social service of which I have any knowledge would be required to reduce its services below a practical minimum if the corporation contributions were withdrawn.

Senator GORE. Would that not tend to create a necessity that would be devolved upon the Government hereafter to take care of?

Mr. BAKER. Ultimately yes, sir; but the Government would lag in assuming those duties; there would be a period of lag during which the injury, both to the character and to the health of the Nation, would be very great.

Senator GORE. Do not you think it would be regrettable if the social burden would be placed permanently on the taxpayers?

Mr. BAKER. Senator Gore, ultimately it will. The history of philanthropy and its relation to government is that philanthropy pioneers new needs and discovers new social needs for relief which have not been recognized by government, and after a while, when philanthropy has experimented with that, the government recognizes its obligation and takes that over and releases philanthropy for new pioneering.

Senator GORE. You think that is the philosophy of it?

Mr. BAKER. That seems to me to have been the history of it, sir.

Senator GORE. I was wondering why the government recognized the obligation.

Mr. BAKER. Every government that I know of, Senator Gore—and I am speaking of our American governments—operates hospitals of one sort or another. Originally hospitals were all operated by religious institutions or private institutions.

Senator GORE. Is not the tendency of any government that exists today, or that has existed, where the people are elected by popular vote and can get votes by extending these services, whether needed or not, that the government that has assumed the responsibility of those services has gone in the past?

Mr. BAKER. Yes.

Senator GORE. I am speaking of the history of Rome, where everything went in threes until they lost their freedom, and the same thing in Africa.

Mr. BAKER. I have just been reading "Claudius the God". I am pretty familiar with the Roman experience on that subject. I wholly agree with you, but the taking care of people who are sick and building the character of the young are just two of the experiments that Rome never tried. She undertook to amuse them with circuses, feed them with bread and wine, and I am not in favor of the latter.

Senator GORE. You draw the line there. Of course the theory is that these restitutions on the part of the Congress in a sense suborn the good will of the public, tends to make the public a little more tender in the regulation of these corporations. Do you think that is possible?

Mr. BAKER. I have heard that stated, but my notion is that very direct benefits and great social advantages come from having the corporation get the goodwill of the people among whom it operates.

Senator GORE. I was talking to a representative of a large concern the other day in one of my towns in the State and he said he contributed about \$7,000 a year, and he said if this bill passed they would be relieved of that charge and would have a perfect alibi to say to the people they could not make contributions.

Senator BARKLEY. As a matter of fact they can do it now. There is no exemption now in the law from these charitable contributions unless they can be held to be a business expenditure in the course of the business of the corporation.

Mr. BAKER. That is quite right, Senator Barkley.

Senator GORE. It goes to organized charities and concerns of that sort, is that right?

Mr. BAKER. May I make this suggestion, Senator Barkley. The fact that the question has now been raised gives it no importance.

Senator BARKLEY. Those who have not enjoyed but who now desire to enjoy complete exemption from tax on all their donations, regardless of whether it has any connection with their business or not, they now get exemptions on such donations that are interpreted to be a business expenditure. For instance, if they make a donation of \$10,000 for beds in a hospital for the benefit of their own employees, that might be a business expenditure, although for charitable purposes which would give them an exemption on that donation from the income tax, but if they just donate generally for the public without any particular connection with its company or its employees, they do not get an exemption from the income tax.

Mr. BAKER. That has been the Treasury position until recently, I understand. There is some disposition on the part of the Treasury to even revise that. We feel any contribution, even to a hospital, is open to question, but difficulty with that we think is this: Now that this question has been raised here, if Congress, having this matter before it, decides that these corporation contributions are not to be exempt, it will, in a sense, be taken as an expression of your belief that they ought not to make them, and it will increase our difficulty in getting corporate contributions. In 20 States there is no difficulty about the law where the legislatures have authorized it.

Senator GORE. My recollection was that the contribution had to be made through an organized charity, or some organization that will fall within that description.

Mr. BAKER. I think that is the language.

Senator BARKLEY. Do you think the 5 percent provision is a little high?

Mr. BAKER. I do not think the 5 percent makes much difference. No company will approximate that.

Senator BARKLEY. Since we are dealing with psychology, it strikes me, inasmuch as probably no corporation is going to do it, the public might get a wrong idea about it if that high percentage of net income which they might donate be exempt from taxes.

Senator CONNALLY. Mr. Secretary, Senator Gore suggested that he had some corporation in his State that had been giving \$7,000 a year. If this law passed they would be relieved from that moral obligation and moral urge. Now, under the law, they would only pay 14.75 percent of that if they were not allowed to deduct it, would not they?

Senator BARKLEY. Thirteen and three-quarters percent.

Mr. BAKER. That would depend on their gross income, I suppose. It is varying percentages.

Senator CONALLY. It is no flat rate?

Mr. BAKER. Under the present tax, yes.

Senator CONNALLY. Under this a corporation would have a great humanitarian outlook to want to give \$7,000 for charity, but if they had to pay 13¾ percent of that they would not pay anything, is that the attitude? I wonder if that is the attitude of all corporations?

Senator GORE. I do not know what the attitude would be. I think they feel they are under a moral pressure, a moral coercion to make the contributions. If the Government said they cannot do it then they would not have that moral pressure.

Senator CONNALLY. The Government does not say you cannot do it. The Government would be glad to get the donations. I just wondered whether that was the attitude of all the corporations, that they have a tremendous humanitarian urge, they want to give support to these charities, but if they had to pay as much as 13 percent to the Government they ought to be absolved from any moral urge.

Mr. BAKER. That is not the attitude.

Senator CONNALLY. I hope that is not.

Mr. BAKER. They have already contributed 25 percent of the gross sum raised throughout the Nation, and paid the tax in addition, so that their humanitarian motive is unimpeachable, I think.

Senator CONNALLY. I hope so. It is under the present law that they pay the taxes?

Mr. BAKER. Yes. I am hoping if they are exempted from the tax they will pay more than 25 percent.

Senator COSTIGAN. Mr. Secretary, in view of your suggestion that the corporation contributions are fractional, do you favor such large exemptions as 5 percent of the corporation's net income?

Mr. BAKER. I said to Senator Harrison it did not seem to me the 5 percent would ever be approximated by any corporation's gift. You might run on to some small corporation in a relatively small town where nobody has any money except the corporation, and in order to keep even a 1-room hospital going it might be necessary for that corporation to go up as high as 5 percent, for its own employees.

Senator COSTIGAN. Have you known of any such cases?

Mr. BAKER. I have known of such cases, and I have known of variations from such cases. 5 percent is not dangerous.

Senator GORE. Your idea, Mr. Secretary, is this should be limited to organized charitable organizations, not educational institutions?

Mr. BAKER. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Baker.

We have several witnesses here. Mr. Prentis.

**STATEMENT OF H. W. PRENTIS, LANCASTER, PA., REPRESENTING
ARMSTRONG CORK CO.**

The CHAIRMAN. You are representing the Armstrong Cork Co. of Lancaster, Pa.?

Mr. PRENTIS. Yes, sir.

My name is H. W. Prentis, Jr., of Lancaster, Pa. I am president of the Armstrong Co. and come here today representing the National Association of Manufacturers.

I wish to discuss particularly that portion of the pending tax bill which has to do with the graduated tax on corporate income. The fact that the graduation proposed in the House bill is confined to the narrow limit of 1 percent does not alter the fact that it introduces a new principle into the taxation of corporations—a principle that seems to me to be unfair and unsound. Experience teaches that once the opening wedge is driven, the field covered by a new tax tends to expand steadily. The way to deal with any proposal that appears to be basically unwise is to oppose it from the start and eliminate it if possible. Surely here an ounce of prevention is worth a pound of cure. It is the primary principle of this proposed legislation that we deplore. The yield in its original form as suggested by the President with rates ranging from 10¼ to 16¼ percent has been estimated at upward of \$60,000,000. In its revised form with rates varying from 13¼ to 14¼ percent the additional income would be approximately \$15,000,000.

Obviously, this new tax is not designed primarily for revenue purposes. What then is the motive underlying it? Apparently to control or limit, perhaps as the idea is expanded in future years, to break up or destroy large businesses simply because they are big, in the belief that in some fashion this will result in a broader distribution of wealth. But if we destroy or interfere unduly with the creation of new wealth, how can there be constantly more wealth to distribute? In this connection the amount of misinformation that has been given credence is appalling.

A striking article in the current *Annalist* by Robert Doane was summarized in an editorial in the *New York Times* a few days ago, and since it throws new light on this little-understood subject I quote a few excerpts from it:

Mr. Doane begins by pointing out that, while all figures on private wealth and income, official and otherwise, are estimates rather than actual census enumerations, we at least have enough information to know that such often-repeated statements as "2 percent of the people own 40 percent of the wealth", or "4 percent of the people own 87 percent of the wealth", bear no relationship to the facts.

He does find that at a maximum some 6 percent of the people hold in gross miscellaneous claims, property currently valued at approximately 50 billions of dollars. This 6 percent embraces all of the wealthy and a substantial portion of the middle class—about 4,000,000 people. In this class, those receiving \$5,000 annual incomes and over will be found "large numbers of our duly elected public officials, various trade, civic, and farm organization executives, a sprinkling of

college professors, doctors, dentists, lawyers, actors, clergymen, and last but not least, a considerable number of labor-union officials."

Suppose this 51 billions of property were taken away from these people and shared among the remaining population. Each one according to Mr. Doane's calculations would be enriched to the extent of \$1.41 in bank deposits and cash, \$1.72 worth of old clothing, \$4.27 worth of second-hand furniture and household furnishings, \$43.15 worth (as the pro rata share) of indivisible bricks, mortar and widely scattered real estate, and an additional block of securities to an amount equivalent to an income of 5 cents a day.

Wealth distributed in such fashion obviously would be dissipated by most of its recipients in short order. On the other hand, when gathered together in blocks of appropriate size—commensurate to the size of the task to be accomplished—capital creates new wealth through the production of new goods and services, and thus maintains and gradually raises the general standard of living. A corporation is simply a vehicle by which myriads of small lots of individual wealth can be assembled and grouped together in sufficient volume to do an effective, new wealth-creating job.

The proposal for a graduated tax upon the net income of such wealth-creating agencies is not a small problem involving only a few corporations with large incomes. The program affects literally millions of persons, for a corporation is simply an aggregation of individuals who have invested in the same company. Profits earned belong to the stockholders. The corporation is merely the temporary holder of such income.

To increase the tax on the profit of a corporation is therefore to increase the tax on the income of individual stockholders and to reduce this income, all without regard to the ability to pay for each individual concerned. The real sufferers then, as a result of this graduated tax proposal, aimed ostensibly at big business, would be the millions of private persons who own the corporations. Not only would individual incomes be reduced but the market value of securities would be adversely affected eventually since once the principle is introduced it will tend to be perpetuated and extended.

Wide extent of corporate ownership: To assume that only a relatively small number of people are affected by a tax on corporations would be to ignore their essential nature. With the advent of large industrial units, America has developed a system of public ownership of the tools of production to an extent not equaled elsewhere in the world. Hence the graduated corporation income tax is a threat to the welfare of millions of thrifty people who have invested their savings in our business corporations.

In the United States there are, with varying business conditions, from 80,000 to 250,000 corporations operating at a profit in any given year. As of January 1, 1935, there were 663 issues of nonrailway common stocks on the New York Stock Exchange with a total market value of \$25,086,000,000. The average value per share was \$23.50. An analysis of the holdings of common stock in 31 companies showed average holdings of only 117 shares each. Assuming that holders of common stock in all companies own a similar number of shares each, then there were on January 1, 1935, a total of over 9,161,000 owners of common stock of nonrailway companies listed on the New York Stock Exchange. In 103 industrial companies alone, from which it has been possible to gather specific figures, there were 3,915,000 registered stockholders of common stock.

Berle and Means in their book, *The Modern Corporation and Private Property*, estimated that in 1928 there were 18,000,000 registered stockholders comprising perhaps 7,000,000 individuals. The stockholder lists of scores of big corporations show that small stock holdings serve a purpose that might be described as secondary savings bank accounts. For example, General Motors Corporation, representing a market value of \$1,700,000,000, is owned directly and indirectly by some 415,000 stockholders. Holdings of more than 150,000 of these stockholders represent amounts of 10 shares or less, involving a maximum investment of \$350 each. Only 7.8 percent own 101 shares or more.

Of the American Telephone & Telegraph Co.'s 675,000 stockholders, 38 percent own 1 to 5 shares each; 21 percent own 6 to 10 shares each; and 21 percent 11 to 25 shares each. Only 20 percent of the stockholders own over 25 shares each and no stockholder owns as much as 1 percent of the stock. Furthermore, 56 percent of the stockholders of this corporation are women, and 210,000 are housewives.

In private operating electric light and power companies there are nearly 1,550,000 stockholders. Of these, 10 percent own only 1 share each and 75 percent own 10 shares or less, while two-thirds of all the stockholders are women.

These figures serve to show that there is no such thing in the United States as an investors group distinct from those who work for a living, because wage and salary earners also are investors. Damage industry by an increase in corporation income taxes and you hurt all who are dependent upon industry for income.

A graduated tax on corporation income is unsound and unscientific and violates the principle that taxes should be related to ability to pay. The small income of a very small corporation may mean a large profit upon investment and a large income of a very large corporation may mean inadequate profit on capital employed. Thus instead of being a tax under which those with greater ability to pay are taxed more heavily, the proposed tax may actually result in a situation under which those with less ability to pay will bear a greater burden.

Furthermore, a tax which penalizes efficiency is unfair and contrary to the genius of the American people. Because a large corporation has attracted more customers, sold more goods and operated effectively it is neither economically wise nor ethically fair to place a heavier tax upon the profits of that company than upon the earnings of a corporation of the same size which has not been as efficient and therefore not made as much profit. It is unsound also to penalize the individual who used good judgment by investing in a small company which later becomes successful and makes substantial profits. Such success should not be penalized.

The record, I am sure, is clear as to the contribution that large-scale industries have made to the high and growing standard of living, for all our people. In general, America's large industrial units are the logical result of the advantages of mass production. To enable luxuries to be turned into necessities and new luxuries to be continually created requires the concentration of adequate resources. It is only by utilizing the many processes and forces of large industrial units that we are able to eliminate waste, cheapen the cost of production and distribution, and thus cultivate and extend the demands of national and international markets.

It cannot be denied that, with the present organization of American industry, the American people as a whole have reached an unprecedented level of comfort and a standard of living that is the envy of the civilized world. In his tax message to Congress, President Roosevelt himself said:

In the modern world, scientific invention and mass production have brought many things within the reach of the average man which in an earlier age were available to few. With large-scale enterprise has come the great corporation drawing its resources from widely diversified activities and from a numerous group of investors. The community has profited in those cases in which large-scale production has resulted in substantial economies and lower prices.

Must we then "penalize the elephant for not being a flea?"

A large corporation is able to diversify its activities as a protection to its stockholders. Its wages are usually at the highest level commensurate with the value of the service performed. Its credit is normally more sound and, consequently, the cost of its financing can be kept at a minimum. It holds out to its younger employees greater and more varied opportunities for advancement.

Many workers in America are capitalists already. In 1930 there was an automobile for 4 out of every 5 families, 2 out of every 3 families had telephones and electricity, and 40 percent of all families had radios. In 1932 there were more than 44,000,000 savings accounts in banks throughout the country with aggregate deposits exceeding \$24,000,000,000. There were in addition over 1½ million Postal Savings deposits with total savings of over 1¼ billion dollars. In the same year there were about 10,000,000 members of building and loan associations with assets approaching \$8,000,000,000.

At the beginning of 1932 there were over 33½ million ordinary life-insurance policies in force for a face value of over \$90,000,000,000, and there were in addition over 88¼ million industrial policies calling for the payment of almost 18½ billion dollars.

That bigness has been the ideal of many Americans needs no apology, and I have the strong conviction that the years to come will find just as many young Americans as ever before, eager to adventure and perfectly willing to exchange dubious security for the chance to attain riches and comfort and the opportunity to help their fellow men that wealth provides. That is a force to be reckoned with in all economic and political calculations of the future.

CONTINUING DEFICITS

The net Federal Government deficit for the fiscal year ended June 30 was over \$3,575,000,000, not including contingent liabilities. The national debt totaled nearly \$29,000,000,000 and will be further increased during the present year nearly 14 percent by the \$4,000,000,000 program for public works now under way.

New taxes can be intelligently levied only against a budgeted estimate of expenses, and then only after all unnecessary expenditures have been eliminated. The Federal Government is spending today about double its income, and while present tax rates are already bringing in larger returns than the Government received in any year from 1923 to 1928, it is evident that no practicable tax schedule will provide sufficient revenue to balance the Budget if expenditures are continued on the current scale. We have spent in 2½ years as much

as the whole outlay of the Federal Government in the 124 years from Washington to Woodrow Wilson. Obviously the Budget must be balanced ere long if the public credit is to be maintained.

There are three ways in which we may attempt to do so:

(1) Through increased Federal taxation. Industry opposes the proposal for a graduated corporation income tax because the rate of tax suggested bears no relation to the percentage of profit earned on the investment and taxes the millions of small investors in large corporations at a higher rate than either large or small investors in small corporations. A graduated corporation income tax is moreover a handicap on success, a penalty on efficiency.

Moreover increased taxes may well prove to be an antirecovery measure. In 1919 President Wilson said:

There is a point at which in peace times high rates of income and profits taxes discourage energy, remove the incentive to new enterprise, encourage extravagant expenditures, and produce industrial stagnation with consequent unemployment and other attendant evils.

And President Roosevelt during the 1932 campaign made the following significant statement:

Taxes are paid in the sweat of every man's labor because they are a burden on production and can be paid only by production. If excessive, they are reflected in idle factories, tax-sold farms, and end in hordes of the hungry tramping the streets and seeking jobs in vain.

Congress should carefully consider whether the proposed tax measure would not throw a wrench into the wheels of recovery at the very time when we should be making every possible effort to speed them up.

(2) Through a return of prosperity. A substantial business revival with present tax rates would yield annual revenue estimated at over $4\frac{1}{2}$ billion dollars, which would be ample to cover all the necessary expenditures of the central government and gradually amortize the debt created during the past 3 years.

(3) Through a reduction in Government expenditures. The only honest way to avoid paying debts is not to contract them. The President pledged a reduction of 25 percent in ordinary expenditures, yet the budget for ordinary expenditures as distinguished from the emergency expenditures for the present year is greater than for any previous year. Is it any wonder that business hesitates, that the investment of capital in new enterprises almost ceases, that capital instead seeks refuge in Government tax-exempt securities, and that unemployment and privation continue to stalk through the land? Mounting Government expenditures with the necessity of increased taxation are a real menace to our whole economic structure. What should be done?

First, there should be a sincere and vigorous effort to restore confidence to the minds and hearts of private investors and harassed business by calling a halt on social experimentation and putting economic recovery definitely ahead of further purging and reform. A member of Parliament said 200 years ago, after the South Sea bubble burst in England, and the populace, victims in large measure of their own greed, were crying for vengeance:

If the city of London were on fire, all wise men would aid in extinguishing the flames and preventing the spread of the conflagration before they inquired after the incendiary.

If confidence be restored by a return to what has heretofore been regarded as sound constitutional procedure, I am convinced that, with the huge pent-up replacement demand that exists in virtually every department of industry, we would witness a revival of economic activity that would speedily remove from relief rolls millions of our suffering unemployed, and create a flood of additional revenue at present rates of taxation. Simultaneously, real economy measures should be made effective in every department of Government. Then, after the searching study that the vital importance of the subject merits, let our whole system of Federal taxation be revised: The tax base broadened to include the majority of the 94 percent of our citizens who now pay no income tax at all; estate levies placed at a level that will not destroy going businesses and create unemployment; and corporation taxes whatever the rate may have to be, applied equitably to all alike so that the stockholder's stake in his company's profits will pay no more and no less relatively than his neighbor pays on his holdings in a competitive enterprise.

Senator CONNALLY. You want to return to the normal constitutional processes?

Mr. PRENTIS. Yes.

Senator CONNALLY. You mean those that were employed in 1929?

Mr. PRENTIS. Throughout the entire period of the country's history, from 1789, Senator.

Senator CONNALLY. You said you want to return to the normal constitutional processes. You mean 1929, 1930, 1931, and 1932? Those were the ones existing just before we came in. Do you want to go back to those?

Mr. PRENTIS. I am not going back to any specific year.

Senator CONNALLY. We would like to know. We cannot just feel around in the air. When is this particular period that you want to go back to? What period is that?

Mr. PRENTIS. I want to go back to a period in which the legislation which we enacted is, as far as I can ascertain, in general accord with the spirit of the Constitution of the United States, sir.

Senator CONNALLY. Well, in 1929 everything was constitutional, wasn't it?

Mr. PRENTIS. I think so, on the whole.

Senator CONNALLY. You want to go back to 1929?

Mr. PRENTIS. I am speaking of legislation, not speculation. We have had recurrent periods of speculation in this country and, in my opinion, always will so long as human nature is human nature. This ever-present tendency to speculate—to try to get something for nothing—is strikingly brought out in the first three chapters of one of the most interesting books I have read in years, entitled, "Great Popular Delusions and the Madness of Crowds", written by a man named McKaye, and originally published in 1841—recently reprinted in Boston. One chapter deals with the unbelievable tulip speculation in Holland in 1634, another with John Law's Mississippi Bubble in France in 1720; and another with the South Sea Bubble in London about 1727. We all know what happened in Florida in 1924, and, in my opinion, if all of us here live 20 years longer, we shall see the American people break out in another orgy of speculation in some

direction. What it will be, I do not know, but I do know that it will have as its objective the idea of getting rich quick, of getting something for nothing. I am just as much opposed to the wild speculation that took place in 1928, 1929, and 1930 as you are, Senator, but I am thoroughly convinced that while legislation may tend to curb speculation, it will never cure it.

The CHAIRMAN. The committee will have to recess. There are several witnesses who were scheduled for this morning, but they will have to go until tomorrow morning.

(Whereupon, at 12 noon, the committee recessed until tomorrow, Friday, Aug. 2, 1935, at 10 a. m.)

REVENUE ACT OF 1935

FRIDAY, AUGUST 2, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in the Finance Committee Room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

Present: Senators Harrison (chairman), King, George, Walsh, Connally, Gore, Loneragan, Gerry, and Capper.

The CHAIRMAN. Is Mr. Harry E. Sheldon here?

(No response.)

The CHAIRMAN. Harry E. Sheldon, representing the Allegheny Steel Co. of Breckenridge, Pa.

(No response.)

The CHAIRMAN. Franklin W. Ganse, of Boston, Mass.

Mr. GANSE. Yes, sir.

The CHAIRMAN. How much time do you desire this morning?

Mr. GANSE. I think about 15 or 20 minutes, Mr. Chairman.

The CHAIRMAN. We have here about 15 witnesses this morning. I hope you can make your remarks brief, and then you can elaborate them and put into the record anything that you desire. Try to finish in just as brief time as possible, because we must finish these witnesses this morning.

Mr. GANSE. Thank you, Mr. Chairman.

STATEMENT OF FRANKLIN W. GANSE, BOSTON, MASS.

Mr. GANSE. I am particularly interested in the inheritance-tax and gift-tax features of the bill which has been submitted to the House.

The title of the bill, as is customary, states that it is to provide revenue. Under that feature I suppose the segregation of the revenue would also be considered. That is a peculiar thing in this bill, the recommendation of the President that certain parts of this revenue be segregated to apply on the public debt or to help balance the Budget.

And to equalize taxation—I wish in a very few minutes to point out that this bill does not equalize taxation, but absolutely discriminates against the taxation of very large estates, and practically seizes them or results in confiscation.

And, third, for other purposes—I suppose the other purposes would very properly include the recommendation without which we never would have heard of this measure probably, the recommendation of the President in his special message June 18 for a wider distribution of wealth. That certainly does not come under the equalization of taxation or the providing of revenue.

The reference to inheritance and gift taxes in the President's message was very brief. It is on page 3 as that message is printed. He recommends that in addition to the present estate tax, there should be levied an inheritance, succession, and legacy tax, not as embodied in the bill as it is now pending before the House but a legacy or succession or inheritance tax on all very large amounts received by any one legatee.

The bill as now pending has departed entirely almost from the President's recommendation and increases inheritance taxes or levies an inheritance tax on small amounts down to anything above \$10,000 in the case of those who are not next of kin, and anything above \$50,000 received by any one legatee of next of kin.

I would like to direct the attention of the committee especially to the fact that the President's message, without which we never would have heard of this measure—I believe the chairman would admit—only refers to the imposition of an inheritance tax upon all very large amounts received by one legatee.

There is certainly no reference there to an imposition of an inheritance tax on amounts as low as \$10,000.

In leading up to that suggestion, the President, quoting President Theodore Roosevelt, made references to "enormous" estates, and the whole argument is based on the effort to secure the distribution of very very large estates and not the taxation of moderate or small estates.

May I point out that the proceeds which the President recommends should be segregated are only the proceeds of the inheritance tax? The Secretary of the Treasury in appearing here yesterday renewed his suggestion that the proceeds of all of the taxes levied by this bill should be segregated for the balancing of the Budget or the reduction of the national debt. The proceeds recommended to be segregated by the President are only the proceeds of the inheritance tax levy. Those, as represented in an estimate I have seen and which you are all familiar with, will probably amount to \$90,000,000. If those are segregated for the purpose of paying off the national debt as recommended by the President, the \$90,000,000 would pay off the national debt, if interest can be taken care of in other ways, in about 300 years, and therefore they are not very satisfactory for that purpose.

Now, Mr. Chairman, I want to particularly emphasize the fact that this bill does not equalize taxation, and I think therein rests the greatest objection to the inheritance-tax bill, that instead of equalizing taxation, they provide that legatees who receive moderate amounts will receive a substantial portion thereof. Legatees of very large estates who receive very large amounts will receive nothing; in other words, in respect to estates of a million and a half or over, this bill as it now stands is confiscatory.

What I mean by confiscatory is that it is practically confiscatory. It is true that taxes levied on receipts of legatees of a million and a half dollars, would only amount to 50 or 55 or 60 percent thereof.

Further on, in the case that Senator Lonergan referred to yesterday, they might go as high as 88 percent of a \$500,000,000 legacy, but in a legacy of a million and a half dollars, the amount taken by the Government under the present law, the act of 1934, and this new act if enacted, would be 55 or 60 percent.

The expenses of administration must be added. I am sure that the Senators will recognize that the expense of administration will be very largely increased if this bill is passed as introduced. It will require expert legal work to a very large amount to straighten out the claims which will arise under this bill. The expense of administration might be put at 10 percent.

So that, the amount that the Government takes is 60 percent, and with 10 percent expense for administration, there is 70 percent.

In many of these cases, I believe, following the matter that was taken up here yesterday, there will be a request for extension of time because undue hardship will occur to the estate if extension of time is not granted. If that extension of time is granted, the interest will be 3 percent for 3 years and 6 percent for 7 years.

Six percent will kill any estate just as it will kill any business that is involved in an estate, under this bill. Six percent for 7 years is 42 percent. Granted that that estate will earn during those 7 years' extension, 3 percent, which is putting it high, that is 18 or 20 percent more gone.

You have the Government taking 60 percent, the expense taking 10 percent, which is 70 percent, and 20 percent more now for interest for extension of time is 90 percent, and I have left out entirely the immense shrinkage that will occur to all estates and all legacies due to the fact that so little is going to be left.

In other words, if a legatee is left a million and a half dollars, and everybody knows, creditors and beneficiaries and everybody else knows that that million and a half will only be worth say \$150,000 to the beneficiary instead of a million and a half, the shrinkage that will take place in the assets of that estate will necessarily be very large because of the necessity to turn it into cash.

Now, Mr. Chairman, view it from another way. England has had the most experience with death duties of any country in the world. The fiscal policies in England regarding great estates are certainly sound and wise.

England puts a 50-percent tax on the largest estates, and not exceeding a 10-percent inheritance tax. Her inheritance tax in addition to the estate tax runs from 1 to 10 percent. This one runs from 3 to 75 percent and in England there is no additional state inheritance tax.

It is absolutely confiscatory, and ridiculous on the face of it, to put an inheritance tax on of that size. And for two reasons: First, it is unfair if it results in practical confiscation.

Secondly, it defeats its own purpose. The history of the world shows that if you make taxes too heavy, they are uncollectible. That is perfectly natural.

Take a man who is going to leave a \$10,000,000 estate to one beneficiary. Under this bill, if passed as introduced, that beneficiary will receive, leaving out the expense of administration and those other shrinkages I have spoken of—let us put it this way—the Government will take \$7,300,000 out of that \$10,000,000. That man can move to an island in the sea or go to several countries in the world and spend part of his year there, and a large part of the year in the United States and save these taxes. He is practically being offered by that country \$7,300,000 to move there.

You only need the history of our country back in the middle twenties when Florida was the place for people to go to who wanted to avoid inheritance taxes, and you know what happened. Florida was offering them refuge; people were flocking there changing their residence from other States. Georgia took a step to abolish its inheritance tax and follow the State of Florida, and State after State was doing it, until the Government came to the rescue and adopted the 80 percent credit feature and said to Florida and all the other States which did not impose an inheritance tax, that if they did not impose an inheritance tax the Government would take the money anyhow. You know the history of that legislation.

Let me give the figures in two cases.

Let us suppose that a man is leaving all of his estate to his wife and that estate consists in the ownership of an industry. That estate in one case I will assume to be worth \$250,000. I will assume another man dying at the same time. His estate consists of the ownership of a large industry employing men, worth \$2,500,000. We will assume in both cases that it goes to a class A beneficiary, the wife.

I say that this bill does not equalize taxation, but absolutely discriminates against the \$2,500,000 estate, and it certainly is no purpose of the Senate or of the Government to confiscate and discriminate.

In the case of the \$250,000 legacy to the wife, if she were a resident of Massachusetts, the present Federal estate and Massachusetts succession tax—we call it a succession tax—would take off \$25,000 leaving \$225,000.

Under this bill if passed as it now stands before the House, \$50,000 more will be taken. Yet it will leave to that wife \$175,000, or 70 percent of the estate which her husband left, 30 percent being deducted.

That is a tax that might be called reasonable, although a very heavy tax on a comparatively small estate.

In a \$2,500,000 estate, there would be nothing left under the argument I have made in the belief that this is a confiscatory tax when it takes 50 or 55 or 60 percent for the Government, and besides that, shrinkage, interest on extension, expense of administration and other depletions which will cut it down.

Senator KING. Break that down, please, the \$2,500,000. Just divide that. How much would go to the Government and what would the beneficiary receive?

Mr. GANSE. In the \$2,500,000 estate, about \$1,350,000 would go to the Government if this bill is passed, and about \$1,150,000 to the beneficiary, subject, as I say, to expenses, interest, and shrinkage.

Our claim is that this bill does not equalize taxation between those two classes but absolutely discriminates in favor of the person that owns the smaller estate, and absolutely cuts out the others.

The question I think that should be settled is, is this bill a fiscal bill to raise revenue? We know it will not raise much revenue. Is it a bill to distribute wealth? If it were a bill to distribute wealth, a phrase which is at the bottom of the President's recommendations and which appears throughout his special message—I will not stop to argue that—but if it is a bill to distribute wealth, I submit to the committee that the distribution of wealth in every dictionary and proper use of that term does not mean the seizure of wealth by the Government to use it for its own purposes and to pay its expenses.

The "distribution of wealth" means that this large estate of \$2,500,000 is broken up and not all left, as in England under some of their laws of primogeniture, held as one big estate, which is supposed to be hostile to the interest of the ordinary people, but is broken up and left to a large number of people and to charities. That is what the "distribution of wealth" means.

This bill does not provide for the distribution of wealth; it provides for the seizure by the Government and confiscation in other ways of all estates of a million and a half and over.

Does the country at large understand that? The papers do not understand it. I have scanned the editorials of many of the leading papers of the country, and with one or two exceptions, they do not understand what this bill practically does—to take the wealthy estates of the country of a million and a half or over and do away with them and put them out of business.

I am not going into the argument of what that means to the charities, what it means to the maintenance of churches and hospitals and Young Men's Christian Associations and Young Women's Christian Associations and everything else in such categories. I will not touch upon the economic values of reasonable reservoirs of capital.

We all know what it means; if you take the rich of the country, the very rich, those worth a million and a half and over, and they are only a comparatively few in number and give largely to charity—and they are not altogether bad people, not altogether unfriendly people to the masses of the people—if you take those estates and wipe them out, that is one thing; but do not name such a bill "A bill to equalize taxation." The title should be changed to "A bill to discriminate against the rich."

Senator KING. It has been suggested to me in several letters which I have received that it will penalize any person from acquiring any property.

Mr. GANSE. Yes. Michael Pupin comes to this country with 5 cents in his pocket. He invents a wonderful invention which is of use to me and to you and to all the people in the country. The people in the country give him one and one-quarter million dollars, about 1 cent a piece. That is what they gave Michael Pupin, that Serb immigrant boy. This bill says to Michael Pupin, "You can enjoy an annuity on that, but you cannot leave it behind you; we are going to grab it when you are done with it; you cannot leave it."

In other words, it is changing the rich man's estate to a life annuity instead of an estate. It does so on the face of it.

I say respectfully to this committee that I do not believe the papers and the people of this country understand what is being done by this bill.

Let me give roughly on estates of different sizes:

A \$2,000,000 estate will be taxed \$1,050,000.

A \$5,000,000 estate will be taxed \$3,200,000.

A \$10,000,000 estate will be taxed \$7,300,000.

A \$20,000,000 estate will be taxed \$16,100,000.

A \$500,000,000 estate will be taxed \$440,000,000.

If that is the purpose of the bill, I think the title should be changed. In other words, the larger the estate, the worse it becomes.

It does not equalize taxation but discriminates against very large estates. It does not distribute wealth, but forfeits wealth to the Government.

The distribution of wealth is certainly a thing for which very strong arguments can be made. I am not a friend of the very rich estates, but I do believe this, that the distribution of wealth is already planned for under our present estate-tax and gift-tax laws. There are only one or two criticisms of the way those things stand today. If you want this man worth \$2,000,000 to cut up his estate and distribute it so that a large number of small estates would be better than one great big estate, instead of seizing it by the Government, you should encourage gifts, and leave high estate taxes. That is just the position we are in under the 1934 act, but we do not encourage gift taxes enough.

The Government is carrying water on two shoulders by saying, "We will tax your estate heavily if you leave it, and we will give you a much lower gift-tax rate if you will be kind enough to give it away while alive."

But the minute he starts to give it away, the Treasury Department comes in and they will try to prove that he did not give it away, but held some sort of an interest so that it should be taxed in his estate. The gift taxes should be more liberal. The gift-tax sections of the bill will only yield \$24,000,000. That is a very small amount even out of the \$270,000,000 which the bill is supposed to yield.

Suppose you loosen up and let the gift tax be levied. What is going to happen? It is happening today. People will give away in trust to their wives, daughters, charities, and friends and all kinds of people; they will give away and thus distribute their wealth, and if that is the thing the Government is after, the distribution of wealth, why not draw a bill that will lead to that? Liberalize the gift-tax provisions somewhat. This can be done by increasing the exemption to next of kin to \$100,000 or \$200,000 instead of \$50,000.

For example, the gift-tax provisions now as embodied in the bill of 1934 are very extreme as to what is "contemplation of death." In the old days, John Wanamaker gave away large sums of money, and the Supreme Court held that it was not in contemplation of death, although he was over 80 years of age, because he had no fear of death, no disease, and no reason to contemplate death particularly.

What have we done now? On the 1934 clause, everything is in contemplation of death that has any reference whatever to a man's estate. A man worth \$2,000,000, and he is going to give his married daughter \$200,000 today. It is in contemplation of death because he probably thought whether he should give it to her today or leave it to her in his will, and therefore he thought of his death in connection with it, and the mere fact he thought of it is in contemplation of death. That is an absolutely absurd definition of contemplation of death.

This refers to the Revenue Act of 1934, of course, but I do say that this bill could be liberalized as to the gift tax if you want to distribute wealth. Do you want to distribute wealth or do you want to seize wealth? Do you want to distribute wealth and make a large number of small estates out of these few very large estates, or do you want to seize them?

Is the man that leaves a large amount of money to leave nothing at all, whereas the man that leaves \$250,000 can leave \$175,000? If that is the purpose of the bill, that is the way it is drawn and it is a very successful bill.

In speaking of contemplation of death, there are two or three other matters I will refer to very briefly—one most important matter; and I hope you will allow me a few minutes more. It is this matter of the extension of time. The extension of time, if you are going to put in these heavy taxes—

The CHAIRMAN (interposing). What do you think is a fair extension of time?

Mr. GANSE. I think the 10-year extension is all right, but the rate of interest should not be over 4 percent. If the rate of interest is going to be 6 percent, you are going to kill it; 6 percent for 7 years is 42 percent. What does the man have to do to get the extension? He does not get it automatically.

The CHAIRMAN. On that proposition, the committee is going to give very careful consideration.

Mr. GANSE. I am very glad to hear that.

One other point you may not have thought of.

If this bill stays the way it is, it should have another title besides the discrimination title which I have spoken of; It should be called, "A bill to increase unemployment", because where those estates as in the case Senator Lonergan spoke of, and there are thousands of them—consist of close corporations with a majority ownership, where those estates are of that character, there should be injected into the bill the instruction to the Commissioner of Internal Revenue to co-operate in every way to allow industries or businesses, which employ a large number of people, to borrow money and to reorganize in order to go on.

I hope the Senate will consider not only the cutting down of the rate of interest, but the injection of something like that to save industries, particularly those that employ a great number of people.

The CHAIRMAN. Have you any suggested amendment there?

Mr. GANSE. I could very easily work up that amendment. It would be substantially this—

The CHAIRMAN (interposing). If you want to work it up and give it to the stenographer, all right. It will be inserted in the record.

Mr. GANSE. I will do that very gladly.

A few years ago, before we had the Federal estate tax, in the State of Rhode Island, a cotton-mill corporation was only saved by the passage in the Rhode Island Legislature of a special bill to let them reorganize and go on and not have to pay their estate taxes.

Here is a vital matter, Mr. Chairman. This bill certainly does not mean what it says on page 18 in regard to life insurance. I really should take 2 or 3 minutes on that. I should take an hour.

The CHAIRMAN (interposing). If you want to elaborate your views, you have the right to do so. We will be very glad to get your views and we will put them in the record and they will be considered by the committee.

Mr. GANSE. Yes. I should just like 2 or 3 minutes.

You will find on page 18, insurance treated in a manner that no other asset is treated in this bill. It is selected and picked out as the only thing that a man cannot give away. He can give away his house if it is not in contemplation of death, he can give away his savings bank account, he can give away bonds, he can give away any securities, but this section says that he cannot give away life insurance.

Why? That is due to an absolute misconception of life insurance by so many of our legislators.

A man of 50 years of age pays \$4,000 a year and buys a \$100,000 policy. He gets that because the company knows and he knows that the average policyholder will live his expectancy, perhaps 20 years, but one man will die next year and one man will die 40 years from now and it will all be equalized. The average man deposits an amount during his expectancy which with interest furnishes the money to pay the claim. That is understood.

In this case, say he is the one that dies in the first year. Mr. Chairman, I wish I could disabuse the committee of the idea that if that man dies in the first year and \$100,000 comes in, there is a great big fat \$100,000 gain to that family. That man, I will suppose, earns \$10,000 a year. That family has a legitimate expectation, in fact the right to think that he will live his expectancy and contribute that \$10,000 a year to their support.

If he takes out fire insurance and pays 1 year's premium and the house burns down and the value of the house is paid, you do not consider that he has gained anything. If he takes out weekly indemnity accident insurance and he is paid a weekly indemnity, you do not think that he has gained anything.

Insurance is a compensation for a loss. Life insurance, where a man pays 1 year and gets back \$100,000 for his wife, and that gives her \$5,000 a year for life, she is the loser to the extent of 50 percent, because that man's life is worth a lot more to his family. You cannot consider life insurance fairly unless you consider it as indemnity for a loss.

The idea that a man takes out a \$100,000 life-insurance policy and it comes in whether he has paid 1 year or 40 years, that that represents a big gain, is absurd. The average man pays in an amount which with interest allows the company to pay his claim. If it were not so, every life-insurance company in the world would be insolvent.

Therefore, I say because a large amount will come in on the immediate death, it should not be thought that here is a great big amount of money, it is easy for the widow to pay, and let us take a large part of it. It should be remembered that a life value, more important than any property value, has been lost, and only partly replaced by the insurance. In everything else that he owns, he can if he wishes, give it away outright, to his wife or to his married daughter or to the other dependents. He can place it in trust for their benefit, he can give it away absolutely and divest himself of all rights, and the regulations now provide the only proper way to treat this matter, the present practice of the Government in regard to it is that he must report as part of his taxable estate all insurance above the regular small exemption if he possessed at the time of his death any element of ownership in it. If he has given it away, he does not report it all.

But this section provides that on the receipt by any person of the proceeds of insurance under policy taken out by the decedent on his own life, even though at the time of his death he did not own any of it, it should be included in the estate.

Is life insurance the only asset to be penalized in this manner? This country is built on life insurance. Over half of our people carry life insurance. The average amount is about \$1,500 including weekly premiums. The average amount of policies is not over \$3,000. And

the American people make more money than any people in the world—forgetting the last few years—they spend more money than any people in the world, and they hedge through life insurance. Eighty percent of the life insurance of the people in the world is on people of the United States.

Are you going to strike at that great economic and thrift measure and say, "You can give away anything else under heaven that you possess, but you cannot give away your life insurance"? Section 203 (a) (7) should be changed so that the last phrase will read "if at the time of the decedent's death he had the right to change the beneficiary or had any legal incident of ownership."

A recommendation was made by Mr. Osgood before the House committee that life insurance earmarked to pay inheritance taxes be free from tax. Several of the States and nearly all of the Canadian Provinces do this. It is in the interest of both the Government and the estate. That is a question I am not going to say anything about because I think there are two sides to it.

At the same time if a man can fortify his estate by giving away life insurance to his beneficiaries, he certainly should be able to do it.

Let us take a very rich man. He desires to provide life insurance that shall pay the inheritance taxes on his estate. He does not know where else in the world the money is coming from. He can pay an annual premium and get \$100,000 or more for that purpose. If he is in the very high class here, what amount of life insurance must he take out to supply that money for his estate? \$400,000 of life insurance is necessary to provide \$100,000 for his estate, because under the bill as drawn the Government will take 75 percent of the very proceeds provided to pay its tax.

The CHAIRMAN. Mr. Ganse, you have occupied now 30 minutes. We thank you very much. If you want to elaborate your views, you can put them in the record.

Mr. GANSE. Thank you.

(Mr. Ganse subsequently submitted the following letter and suggested amendments:)

GANSE-KING ESTATE SERVICE,
Boston, Mass., August 8, 1935.

HON. PAT HARRISON,
Chairman Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR HARRISON: You were kind enough to suggest at the hearing last Friday that I send in a suggestion in regard to the wording of the pending tax bill in regard to the extension of time of payment, and I accordingly enclose the same.

The more I think of it, the more I believe that if this bill is passed, the rate of interest for the entire 10 years of possible extension should not exceed 3 percent, for it is going to be difficult to collect these heavy taxes, particularly where the assets are tied up in close corporations or other business enterprises, and beneficiaries so interested will need the most liberal terms and the longest possible time in order to pay without disrupting business enterprises often employing large numbers of people.

Please accept my thanks for your courtesy to me when I appeared before your committee.

Yours respectfully,

FRANKLIN W. GANSE.

Add to paragraph (f) of section 210 the following:

"The Commissioner shall cooperate in all necessary efforts of the beneficiary or the executor to secure loans, effect reorganizations or in other steps which may be necessary or desirable for the payment of the tax."

Rewrite paragraph (g) of section 210 to read as follows:

"If the time for the payment is thus extended there shall be collected, as part of such amount, interest thereon at the rate of 3 per centum per annum, from the expiration of 6 months after the due date of the tax to the date of the expiration of the period of the extension."

The CHAIRMAN. Mr. J. B. Allman of Washington, D. C., representing the China Trade Act Corporation.

STATEMENT OF J. B. ALLMAN, ATTORNEY FOR CHINA TRADE ACT CORPORATION

Mr. ALLMAN. I represent the China Trade Act Association. I am not opposing this tax bill. I am proposing an amendment to this tax bill, and I want to call upon the chief of the Commercial Intelligence Division of the Department of Commerce to testify in my place. He administers the act and is more familiar with it than anybody else, and it will take less time for him to explain than anybody else.

The CHAIRMAN. Very well. Submit your amendment.

(The amendment proposed is as follows:)

Amendment offered by Mr. ——— to the bill (H. R. 8974) to provide revenue, equalize taxation, and for other purposes, viz page 7, after line 24, insert the following:

"SEC. 107. Credit allowed China Trade Act Corporation.

"SEC. 261 (a) of the Revenue Act of 1934 is amended to read as follows:

"(a) *Allowance of credit.*—For the purpose of the taxes imposed by section 13 and section 702 there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922, in addition to the credit provided in section 26, a credit against the net income of an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possession of the United States, and (2) individual citizens of the United States or China wherever residents, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date: Provided, that in no case shall the amount by which the taxes imposed by section 13 and section 702 are diminished by reason of such credit exceed the amount of the special dividend certified under subsection (b) of this section. The special dividend shall first be applied against the tax imposed by section 13 and to the extent that it shall exceed such tax shall then be applied against the tax imposed by section 702."

"SEC. 108. Capital stock tax credit allowed China Trade Act Corporations.

"SEC. 701 of the Revenue Act of 1934 is amended by adding at the end thereof a new subsection to read as follows:

"(g) For the purpose of the tax imposed by this section there shall be allowed in the case of a corporation organized under the China Trade Act, 1922, a credit against the adjusted declared value of its capital stock an amount equal to the proportion of such adjusted declared value which the par value of the shares of stock of the corporation, owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date."

STATEMENT OF F. R. ELDRIDGE, CHIEF, COMMERCIAL INTELLIGENCE DIVISION, BUREAU OF FOREIGN AND DOMESTIC COMMERCE, DEPARTMENT OF COMMERCE

Mr. ELDRIDGE. We administer the China Trade Act.

The purpose of these amendments is to grant exemption to corporations formed under the China Trade Act from the payment of the capital-stock tax of \$1 per thousand and of the 5 percent excess-profits tax.

China Trade Act companies now are entitled to a credit in the corporation income-tax return on net income proportionate to the amount of stock held by persons resident in China, the United States, or possession of the United States, and individual citizens of the United States or China, wherever resident. The purpose of this credit is to place these corporations on a basis of equality with corporations of other nationalities doing business in China, who pay no income tax to their respective governments on such business. Such corporations under their respective national laws pay no capital-stock tax or excess-profits tax on their corporate earnings within China. To the extent, therefore, that American corporations under the China Trade Act are now so taxed, they are handicapped in their efforts to compete on a basis of tax equality with the corporations of competing nations in China.

The taxes from which exemption is sought by these amendments were levied in the National Industrial Recovery Act for the purpose of providing revenue to the Treasury for the administration of that act.

Senator KING. Was not this same question presented to us when the last revenue act was drafted, and a very strong appeal, as I now recall it, made for these exemptions which you are now asking?

Mr. ELDRIDGE. I think so.

Senator KING. I have forgotten exactly what attitude we took, but my recollection is that we denied the appeal that was then made, or at least modified it.

Mr. ELDRIDGE. I am not familiar with that, Senator King.

Mr. ALLMAN. I do not believe there was any question raised, certainly not by the corporations.

Senator KING. The matter was under discussion, and my recollection is that the full amount requested was not granted.

Mr. ALLMAN. Yes; you are right there. We are not asking for the full amount here. This amendment does not.

Mr. ELDRIDGE. American companies incorporated under the China Trade Act for the purpose of doing business only in China never came within the jurisdiction of the National Industrial Recovery Act. It is now contended, therefore, that they should not have been taxed to provide revenue for its administration.

Corporations formed under the China Trade Act represent an authorized capitalization of approximately \$50,000,000. The tax imposed upon them for the purpose of carrying out the administration of the National Industrial Recovery Act is approximately \$50,000 annually. This added to the cost of doing business by these China Trade Act corporations makes competition with corporations of other nations in China not so taxed to that extend more difficult.

The exemption asked under these amendments is not a total exemption but is to be proportionate to the stock owned by persons resident in China, the United States, or possessions of the United States, and individual citizens of the United States or China, wherever resident.

Senator KING. Let me ask you a question. What proportion of the stock in those companies that are operating under the China Corporation Act is owned by Chinese and what proportion is owned by American? My recollection is that in the former hearings, the contention was made that a number of Chinese would be glad to join in these corporations formed with American capital, and that they did own a considerable part of the capital stock in those corporations.

Mr. ELDRIDGE. That is true. A very large percentage—I have not the exact figures, but it runs well over 60 or 70 percent—is owned by Chinese.

Senator KING. What is the aggregate amount of the capital stock?

Mr. ELDRIDGE. \$50,000,000.

Senator GORE. Do all the other countries grant similar exemptions under their tax as liberal as we are seeking to make ours?

Mr. ELDRIDGE. Yes; all of the other principal nationalities have laws which grant exemption from all taxes on their national corporations doing business in China—Great Britain, Japan, France—

Senator GORE (interposing). Japan?

Mr. ELDRIDGE. Yes.

Senator GORE. Would this exemption constitute a breach of the rule of uniformity requiring that all imports and exports be uniform in the United States?

Mr. ELDRIDGE. It constitutes in a sense tax on exports, because it taxes the corporations which are formed for the purpose of encouraging our trade with China.

The CHAIRMAN. Have you given any thought to the question propounded by Senator Gore?

Mr. ELDRIDGE. No, I have not.

The CHAIRMAN. That it might violate that principle of uniformity?

Mr. ELDRIDGE. I have not given any thought to that.

The CHAIRMAN. We will look into this proposition.

Mr. ALLMAN. With respect to uniformity, this has absolutely nothing to do with the tariff. These corporations do nothing but export.

Senator GORE. I was thinking of the excise tax on capital stock. I was wondering if this would be an arbitrary exemption.

Mr. ALLMAN. This exemption is an exemption as to the stockholders living in China. This imposes the same tax on American residents who own the stock as is imposed upon other corporate stock.

Senator GORE. I thought it exempted both the stock held by the American and by the Chinese.

Mr. ALLMAN. Residents who are actually in China. These corporations do business in China, all of their books are in China, all of their stock and everything else is actually in the continental country of China.

The CHAIRMAN. It is with a view to encouraging these Chinese to go into American corporations?

Mr. ALLMAN. Yes; and if you put this tax on the Chinese who invest their money in these corporations to export products, naturally they resent it.

Senator KING. There is no proposal to exempt American investors and stockholders from income tax or whatever system of taxation we impose here?

Mr. ALLMAN. No, sir. This corporation pays it. That proportion owned by Americans in America. This same identical proposition is in the income tax law of today, and all we ask is that this be inserted in this bill as affecting the excess profits tax and the capital stock tax.

The CHAIRMAN. Is there some other point you wanted to make?

Mr. ALLMAN. No, sir. I would like to extend my remarks in the record and ask the committee to adopt this amendment.

The CHAIRMAN. You may do so.

STATEMENT SUBMITTED BY J. B. ALLMAN, ATTORNEY FOR CHINA TRADE ACT CORPORATION

There are approximately 100 corporations doing business in China organized under the China Trade Act of 1922, and this act makes these corporations domestic corporations. They are formed according to the provisions of the act through the Department of Commerce to export products from the United States to China. Approximately 90 percent of the capital invested in these corporations is owned by residents of China and Chinese nationals. These corporations are formed by agents for American-made products going to China and interesting some Chinese capitalists in the agencies for the particular product to be exported from the United States. Then they form a China Trade Act Corporation. Probably the Chinamen will buy 90 percent of the capital stock and the American agent 5 percent and the manufacturer here at home the other 5 percent. The China Trade Act provides that the officers of the company shall be Americans, therefore Americans control the operations of the corporations.

Experience has taught American exporters to China that it is desirable to carry on this business through corporations, and about 90 percent of our exports to China are through these corporations. The corporations keep all their books in China, all of their property is in China, all of their business is in China. The only business they do in this country is order products from the United States and maintain a statutory agent in Washington, D. C., and most of their capital is Chinese money invested in these companies to export products from the United States.

The China Trade Act having made these corporations technically domestic they are subject to any corporate tax Congress may levy unless exempt therefrom. The present income tax act gives these corporations an income tax credit for that part of the stock owned by residents of China. For example, if the normal income tax imposed upon a China Trade Act corporation for a particular year be \$1,000, and 50 percent of the stock in this corporation is owned by Chinamen residents in China, and 50 percent by John Doe, Washington, D. C., the corporation is required to pay \$500 income tax, provided further that the corporation pays out all of its earnings as expenses or dividends before the return date required for the filing of an income-tax return, and if not they pay full income tax. This latter provision was placed in the law to prevent the accumulation of nontaxed wealth in the corporations.

The Congress of 1924 perfected and made workable the China Trade Act in 1922. The Judiciary Committee of the House made an exhaustive study of this question and presented a written report to Congress (Dyer Rept. 321, 68th Cong. 1st sess.) recommending the above-mentioned method of income tax as to China Trade Act corporations, thus relieving the Chinese nationals from paying taxes to the United States Government on their money invested in the business of exporting products from the United States.

On July 29, 1935, the Secretary of Commerce recommended to the Ways and Means Committee that a bill be enacted into law granting the same credit to the China Trade Act corporations as to excess-profit tax and capital-stock tax. I am advised that the Treasury Department approved of this recommendation by the Department of Commerce before same was made. This recommendation reached the Ways and Means Committee after the pending tax bill H. R. 8974 had been reported. The Commerce Department sent to the Ways and Means Committee a prepared bill. If this bill were introduced and passed it would give the China Trade Act corporations the same credit as to excess-profit tax and capital-stock tax as now obtains as to income tax.

Obviously, Mr. Chairman, a bill introduced at this late date could not pass. You have the very subject before you. This bill increases the excess-profit tax, and I ask this committee to add into this bill the recommendations of the Department of Commerce, the same having been approved by the Treasury Department. I have here a prepared amendment that will carry the Department's recommendations into this bill and I ask you to adopt same as a committee amendment. This amendment I have prepared is taken from the bill recommended by the Department of Commerce. (See Mr. Johnson, of Treasury Department, and Mr. F. R. Eldridge, of the Department of Commerce.)

Mr. Chairman, this is the only instance in the history of the United States in which a tax has ever been imposed upon exports, and a tax imposed upon the China Trade Act corporations is a direct tax upon exports and is also a tax upon foreign capital invested in our export business. I am sure that it was an oversight on the part of Congress in imposing the excess-profit tax and capital stock

tax upon these corporations in the 1934 Revenue Act. The commercial attache at Shanghai advises that the British and other trade people in China have advertised in trade journals in China the fact that Congress has imposed a tax upon corporations doing business in China. These advertisements imply that Congress is frowning upon the export business to China.

The deterrent effect flowing from this form of advertisement, even though the same be untrue, is more costly to business in China than the actual expense of the tax imposed.

Our exports to China held up better through the depression than to any country in the world. Approximately 25 percent of all the imports to China were from the United States, and the bulk of this business was conducted by the China Trade Act corporations due to the fact that all of these corporations have Chinese as stockholders. The imposition of a tax upon these corporations naturally frightens the Chinese business man. They are afraid that Congress will continue to increase the taxes upon them. These corporations do not object to paying their proportionate part of the taxes as may be imposed upon the Americans who live in America who own stock in the corporations. We are not complaining about the increased rate of tax imposed by this bill or any other tax that may be necessary to impose to carry on the expenses of this Government that is now trying to carry us back to a normal state of business, but we do think it unfair to impose a tax upon Chinese who invest their money in these corporations or any other corporations to export products from the United States, as nothing can or will contribute so much to industrial recovery as will the increased export of American-made goods; and that is the whole object of these corporations.

Mr. Chairman, I hope this committee will adopt this amendment and thereby contribute something to the encouragement of our exports.

The CHAIRMAN. Smith F. Ferguson of New York City.

Senator LONERGAN. Mr. Ferguson is president of the Seth Thomas Clock Co. in Thomastown, Conn.

The CHAIRMAN. How much time do you want?

Mr. FERGUSON. Not over 10 minutes.

The CHAIRMAN. Proceed, Mr. Ferguson:

STATEMENT OF SMITH F. FERGUSON, VICE PRESIDENT GENERAL TIME INSTRUMENTS CORPORATION

Mr. FERGUSON. Mr. Chairman and gentlemen of the committee, I am vice president of the Seth Thomas Clock Co., of Thomaston, Conn., and the Western Clock Co., La Salle, Ill. Incidentally, I happen to be the president of the Clock Manufacturers' Association.

The proposed graduated corporation tax, combined with section 351 of the Revenue Act of 1934, will impose an unintentional heavy burden on the company I represent and doubtless on many other companies so situated, and I have asked the privilege of addressing you on this subject.

Section 351 of the Revenue Act of 1934 imposes a tax upon the undistributed adjusted net income of certain corporations at the rate of 30 percent of the amount thereof not in excess of \$100,000 and 40 percent of the amount thereof in excess of \$100,000. Corporations falling within this section include all that derive at least 80 percent of their gross income from royalties, dividends, interest, and annuities and (excepting regular dealers in stock or securities), gains from the sale of stock and securities, if at least half of the value of the outstanding stock of the corporation is, at any time during the last half of the taxable year, owned directly or indirectly, by or for not more than five individuals. For the purpose of determining ownership of such stock, section 351 provides that stock owned, directly or indirectly, by a corporation, partnership, estate or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries;

and an individual shall be considered as owning, to the exclusion of any other individual, the stock owned, directly or indirectly, by his family, and the family of an individual shall include his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

The purpose of the Congress in enacting this section of the Revenue Act of 1934 was doubtless to prevent the evasion of surtaxes by the accumulation of earnings in the treasury of the corporations defined in the act. No opportunity is afforded a corporation to show that it has used and disbursed its earnings for a proper and legitimate business purpose. If the conditions as to ownership of the majority stock and source of income exist, the tax is automatically assessed.

Section 351 is working a grave hardship to those corporations which fall within the definition of personal holding companies but which are in fact organized and operating for strictly business purposes and using earnings to develop and expand legitimate business. A "holding company", so-called, may be supervising and directing the operations of manufacturing units which it controls and using and expending its earnings to develop and expand the business of such manufacturing subsidiaries, and yet it is taxed on such earnings by section 351 on the theory that the earnings are being accumulated in its treasury to evade surtaxes on stockholders.

The section subjects a corporation organized in accordance with law and for sound business reasons to a high penalty tax, in addition to the normal corporation income tax, in cases where there is absolutely no basis in substance or in fact for imposing a penalty tax. Corporations which use and disburse their funds for sound business reasons are penalized with a high penalty tax on the theory that such funds are being wrongfully accumulated beyond the needs of the business.

Senator GORE. What was that?

Mr. FERGUSON. I said that the section subjects a corporation organized in accordance with law and for sound business reasons to a high penalty tax, in addition to the normal corporation income tax, in cases where there is absolutely no basis in substance or in fact for imposing a penalty tax. Corporations which use and disburse their funds for sound business reasons are penalized with a high penalty tax on the theory that such funds are being wrongfully accumulated beyond the needs of the business.

Senator KING. Do you refer to the 5 percent which is imposed upon the earnings after the normal tax?

Mr. FERGUSON. No; I refer to the definition of what a personal holding company is, that if you have 80 percent of your income from dividends and royalties, and so forth, and if five people under the definition of "people" are that, then you come under the definition of a personal holding company. You then cannot receive any dividends from your subsidiaries of a subsidiary industrial unit and use it for another unit. You have to pay it out to your stockholders. I will point that out in a minute, Senator, if I may.

Business policies and projects of many corporations of great benefit to the country and their local communities are made impracticable of execution by this extraordinary tax.

As I stated at the very beginning, a graduated corporation tax or an excess profit tax combined with section 351, would impose a crushing burden.

Consider the facts as to the General Time Instruments Corporation, of which I am vice president, and which is one of many corporations similarly situated affected by section 351. That company was organized on November 20, 1930, to bring under common ownership the Western Clock Co. of La Salle, Ill., and the Seth Thomas Clock Co. of Thomaston, Conn. The purpose was to create a company which would cover a wider field of time-telling instruments. The Western Clock Co. manufactured alarm clocks and nonjeweled watches, and the Seth Thomas Clock Co. manufactured high grade mantel clocks and tower clocks. It was believed that many economies would result from uniting these two companies and combining the management capacity of both and coordinating many of their activities. A committee was appointed of six gentlemen connected with the management of the companies to work out the best plan for their unification. It was finally decided to form a corporation and exchange its stock for the outstanding shares of the two constituent companies. In recommending this plan to the stockholders the committee in a circular letter stated:

The constituent companies are engaged in the manufacture and sale of clocks, watches, and other time instruments, each company confining its activities to special classes and forms as to character and price. The committee believes that it will be for the best interest of all the stockholders, as well as of the trade in general, if the constituent companies are combined under a unified control, and to that end invite the cooperation of the holders of the preferred stock and debentures of Western Clock Co. and the common-stock holders in each company to effectuate the following plan:

No stock was offered or sold to the public.

The General Time Instruments Corporation now owns all of the capital stock of the Western Clock Co. and owns all of the capital stock of the Seth Thomas Clock Co. There are approximately 158 separate stockholders of the General Time Instruments Corporation. A large number of these stockholders scattered throughout the world, with no financial or business connections, are by statute because of family relationship reduced to five individuals. The corporation owns no stock, bonds, or other securities of any other corporation other than the constituent companies, except that it owns the entire capital stock of Hamilton Sangamo Corporation, now in liquidation. Its income is mostly derived from interest and dividends received from the constituent companies. Its only other income consists of payments made to it by the constituent companies to cover the expenses of the research laboratory and for managerial and other services rendered by the parent organization. During 1934 income from this latter source amounted to less than 20 percent of the total income from all sources.

The General Time Instruments Corporation was organized without any regard whatsoever to the matter of avoiding taxation. Its organization was dictated by sound business reasons. It is an important business enterprise in an industry that is essential to the existence of every other industry and to our economic stability and national security. In carrying on its business it has become necessary for the General Time Instruments Corporation to use dividends

derived from the stock of the Western Clock Co. to finance the Seth Thomas Clock Co. because, while the market for alarm clocks and low-grade clocks and nonjeweled watches is fairly good, the market for the high-grade clocks manufactured by the Seth Thomas Clock Co. has been recently practically nonexistent. It is of direct benefit to the stockholders of the General Time Instruments Corporation that its funds be used to assist the Seth Thomas Clock Co. and its employees during this depression rather than disbursed as dividends. Such a policy is of far more benefit and importance in the long run to the stockholders of the General Time Instruments Corporation than a distribution to them of all its earnings. The General Time Instruments Corporation has also found it necessary to use earnings derived from dividends on stock of the Western Clock Co. for plant reconstruction and for reequipment at the Seth Thomas Clock Co.

Yet this corporation which uses and proposes to use and disburse its earnings for sound business reasons is subject to a high Federal tax on all its income including such earnings, a tax as high as 40 percent, in addition to the normal tax, on the theory that it has accumulated its earnings to evade surtaxes on its stockholders. The earnings of the General Time Instruments Corporation have been used and will be used to expand business, create work, and increase purchasing power. A taxing statute which requires excessive distributions to stockholders, denuding a corporation of essential financial resources, necessary funds to conduct and develop business, works in direct conflict with all the plans for economic recovery.

Section 351 plainly operates as to many important corporations to retard business developments and prevent reemployment of labor.

In view of these facts and conditions, we are proposing an amendment to section 351 which will in large measure remove the grave hardship it is now working on sound business corporations, and at the same time will leave all the teeth in the section so far as it applies to holding companies organized to evade taxes. We respectfully suggest the following amendment to title 1A, section 351, Surtax on Personal Holding Companies, Revenue Act of 1934:

Paragraph (1) of subsection (b) of section 351 of the Revenue Act of 1934 is amended by adding at the end thereof a new sentence reading as follows:

"The term 'dividends' as used in clause A of this paragraph shall not include distributions received by a parent corporation from an operating subsidiary, if (1) the parent owns directly at least 85 per centum in value of the outstanding stock of such subsidiary during the entire taxable year; and if (2) less than 80 per centum of the gross income of the subsidiary for the taxable year is derived from royalties, dividends, interest, annuities, and gains from the sale of stock or securities."

Parenthetically I might say that where we put in there, as far as we are concerned, you can put 95 percent in.

Senator KING. Where would that amendment apply to the present bill?

Mr. FERGUSON. It would have to apply back to the 1934 act.

But my point is that combined with your graduated tax, that this places a burden upon a group of people, and I will explain it to you in just a moment if I may.

If this amendment is adopted then corporations organized as holding companies, which supervise, direct, and finance manufacturing companies which they control, can use dividends derived from a prosperous subsidiary to aid or expand the business of a weaker unit without subjecting such earnings to this 40-percent tax.

Permit us to point out that we feel quite confident that the above suggested amendment fully protects the Government; that is, it would not defeat the real purpose of the law and provide a loophole for people who wish to form personal holding companies in order to evade taxes.

May we also draw to your attention that this exception to the law as we have drawn it requires two conditions to qualify; namely, the personal holding company must own 85 percent or more of the operating subsidiary and furthermore—

less than 80 percent of the gross income of such subsidiary operating company must be derived from royalties, dividends, etc.

To our mind these two provisions would make it impossible for anybody to devise a scheme to make use of this proposed amendment to evade the intended purpose of the law, which intended purpose we are very much in sympathy with.

Furthermore, we also think we have protected the Government in our suggested wording by making it very difficult and doubtless impossible for a subsidiary company to be a sub holding company.

I might add in there that this suggested wording, if the principle appeals to you, your draftsman can make the wording possibly better than our suggestion.

Section 351 as now worded and in force is not just or fair. It so works as to drastically inflict grievous discrimination and injury to honest business men by subjecting them to a high penalty tax on earnings used and expended for legitimate business purposes. This discrimination and hardship will in a large measure be corrected by the amendment we have proposed.

Senator GORE. This 30- and 40-percent tax that you speak of, that is in addition to what further tax?

Mr. FERGUSON. To the regular corporation 13¾ percent. I might tell you that the Western Electric Clock Co. on last year's statement paid to the Government between \$130,000 and \$140,000 in taxes.

Senator GORE. That was including both the taxes, the 30 percent and the 40 percent?

Mr. FERGUSON. No. Let me illustrate. We have the Western Clock Co., and we have the Seth Thomas Clock Co. here, and we have the General Time Instruments Co. which owns 100 percent of both of those companies, all of the capital stock of both.

The Western Clock Co., as I pointed out, manufactures cheap clocks and watches and their business has been fairly good very recently. It was not, 2 or 3 years ago.

The Seth Thomas Clock Co., which by the way, is one of the oldest industries in the country, makes high-grade clocks and the market for them is practically nonexistent, and the losses of that company have been very great.

The owners of these companies are desirous of keeping that company in existence. We have not called on the Government for any money as some of our competitors have, but to get money for the Seth Thomas Clock Co., we have to declare from the Western Clock Co., a dividend to the owning company, the General Time Instruments Co., and we cannot get it back from the Seth Thomas Clock Co. The only thing we can do with our dividend is to pay it to the stockholders of the General Time Instruments Co., and if we do not pay it to them, a penalty tax of 40 percent is put on it.

Senator GORE. If you do pay it, you pay the 13¼ percent.

Mr. FERGUSON. We pay the 13¼ percent on any earnings of our subsidiaries. But you caught us in a definition which I think you did not intend to do, and that is the reason I have come before you to ask you to give it consideration.

The CHAIRMAN. We will listen to the Treasury on it and our own experts and will give every consideration to it.

Robert Jolly, Houston, Tex.

Mr. JOLLY. Yes, sir.

The CHAIRMAN. You represent the American Hospital Association?

Mr. JOLLY. I represent the American Hospital Association, and I also represent the Catholic and the Protestant Hospital Associations.

STATEMENT OF ROBERT JOLLY, HOUSTON, TEX., REPRESENTING AMERICAN HOSPITAL ASSOCIATION, CATHOLIC HOSPITAL ASSOCIATION, AND PROTESTANT HOSPITAL ASSOCIATION

Mr. JOLLY. The joint committee of the American Hospital Association, the Catholic Hospital Association, and the Protestant Hospital Association, representing 6,734 hospitals of the United States, of which 4,912 are voluntary or nonprofit hospitals, respectfully requests that nonprofit hospitals be exempt from any provisions of the new tax bill that would reduce their net receipts from individual or corporate gifts, bequests or income.

The proposed new revenue act would accentuate the growing tendency on the part of contributors to reduce charitable gifts to hospitals and other philanthropic institutions.

A glance at the following figures will tell a tragic story and will explain the main reason why over 400 hospitals have had to close in the past 4 years:

Gifts to voluntary (operated not for profit) hospitals

	1929	1934
Private gifts and donations.....	\$58,000,000	\$16,000,000
Legacies and benefactions.....	\$4,000,000	13,500,000
Community chests.....	9,000,000	8,000,000
Other community organizations.....	7,500,000	6,500,000
Money-raising campaigns, subsidies, grants, and all other sources.....	26,500,000	5,000,000
Total.....	185,000,000	49,000,000

These figures show that donations to voluntary hospitals have decreased 75 percent since 1929.

We call your attention to the fact that voluntary hospitals contributed to charity patients, 1929, 7,497,235 patient-days; 1934-18, 733,822 patient-days, an increase of 160 percent.

The CHAIRMAN. Was there not some contribution made by the emergency relief organization to these hospitals for the care of some of these patients?

Mr. JOLLY. No, sir; the Federal Government has never given a cent to the voluntary hospitals of this country, either to pay for taking care of patients or as a donation. The attitude has been, "We will feed and clothe and shelter a man as long as he is well, but when he is sick, let the voluntary hospitals take care of him." We have never gotten one cent of help from the Federal Government.

Their receipts from donations decreased 75 percent, but their contributions to charity patients increased 160 percent.

Remember also that admissions of pay patients fell off more than 30 percent because of their inability to pay. In fact, there have been six contributory elements to the plight of the voluntary hospitals: (1) increase in charity patients, (2) decrease in number of pay patients, (3) decrease in donations, (4) decrease in income from endowments, (5) Government imposition, (6) Government competition.

In terms of dollars our voluntary hospitals made a contribution to the health of the indigent sick of this country to the amount of \$79,056,728 and this without any recompense from Federal relief agencies which thus far have taken the attitude that since hospitals have always borne this burden, let them continue to do so.

Senator KING. What did you mean by Government competition?

Mr. JOLLY. If you will wait just a moment I will come back to that and elaborate on it.

Senator KING. I wish you would.

Mr. JOLLY. Take the case of New York City alone. Its voluntary hospitals last year served 455,000 bed patients and in addition rendered 4,644,730 out-patient service. Over two-thirds of the in-patient and out-patient service was rendered free or part-paid basis. The voluntary hospitals of New York City after receiving payments from patients, endowments, and donations ended the year with unpaid obligations of over \$2,500,000. They started the year 1935 with nearly \$6,000,000 in unpaid obligations for operation, to say nothing of \$14,000,000 of mortgages and long-term obligations.

What is true in New York City is true to an equal or lesser extent in every city and town in the Nation. Some may ask, "How then are the voluntary hospitals surviving?" Our reply is that they are living (1) at the expense of their employees, many of whom are working for maintenance only, others for salaries reduced to much below what they should receive and in some cases receiving only a proration of what is left after the month's bills for necessities have been paid; (2) at the expense of their creditors.

In other words many of the voluntary hospitals are giving away something that does not belong to them and mortgaging their future, but doing so because their motivating spirit is to help as many as possible as long as possible.

Were it not for contributions from corporations and individuals the voluntary hospitals could not render the charity service they now render for such contributions are used almost entirely for charity patients. To lessen the net amount of these gifts by taxation upon the recipient or the donor would decrease proportionately the ability of the hospitals to carry on their charity service. The Government, through our President, has asked all voluntary hospitals and other public welfare activities to enter into partnership with the Government in order that the health of the people may be conserved and that social security may be insured, but the hospitals' end of the partnership thus far has been that of giving out without receiving. And now to further add to the burden some would have the Government put a tax on contributions to voluntary hospitals that have been and are carrying this great load for the Government, for which load the Government as yet has not seen fit to contribute a cent through its relief agencies, much less to pay the actual cost for hospitalizing

these indigents. We believe it would be a lasting shame for the Government to deprive these hospitals of contributions by taxing either the donors or the recipients of such contributions. These hospitals are making a large contribution to the social security and health of the Nation without recompense from Federal relief agencies. They ought not to be asked to reduce this contribution of service in order to make a contribution of money.

Now, may I answer Senator King's question?

The CHAIRMAN. Yes.

Mr. JOLLY. The Senator asked me what I meant by Government competition.

The Government has a lot of veterans' hospitals erected, and that is all right. We think it is fair and proper for the Government to take care of service-connected injuries and sickness in a veterans' hospital. But they have gone further than that. Instead of paying the way of the service-connected patients, they have added the beds for the non-service-connected cases, and that deprives the voluntary hospitals, which have a lot of vacant beds, of those patients. We have handled this load for the Government without any recompense, and we think it is not fair for the Government to go into competition with our voluntary hospitals by putting up more hospitals and more beds.

Senator KING. I would be very glad if you would hand a memorandum to the reporter showing the effect of this competition of the Government and the extent to which it is affecting your organization and the general results of this competition.

Mr. JOLLY. Senator King has just asked what we mean by Government competition and how far it has affected our voluntary hospitals.

By Government competition we mean the Government is constantly putting into operation more hospital beds for veterans when it should be using the vacant beds in the voluntary hospitals. In each of the cities of Chicago and New York today there are 5,000 vacant beds in the general hospitals that could be used for hospitalizing veterans. Half of the beds in the general voluntary hospitals of the entire country are vacant today and the Government should assist these hospitals by paying for the hospitalization of veterans in these beds and save some of these hospitals from going to the wall. These hospitals will take care of the veterans just as cheaply as the Government can hospitalize them in the veterans' hospitals. In fact, we think we can do it more cheaply, for the figures given out by the Veterans' Bureau as their per capita cost per day does not take into account capital expense, depreciation, and interest. The Veterans' Bureau states that for 11 months ending June 1935 the per capita per day cost of hospitalization in the general hospitals was \$3.41. When you read that it costs \$5.40 or more to hospitalize a patient in our voluntary hospitals that figure includes depreciation and interest, and so forth.

We feel that the Government should not compete with us when we are carrying such a heavy load of indigents for it, but should assist and save us by hospitalizing the veterans in our voluntary hospitals. We think it would be better for all concerned. A veteran should be hospitalized in his own community if possible, so he can have his own doctor and be more contented.

Also the local doctors would benefit therefrom because the Government would pay them. You probably know that many doctors are today on relief.

It would also be better for the veteran's family for him to be hospitalized at home, for it would save the expense to which his family is put in visiting him when he is sent away. It would also save the Government the expense of his transportation to and from the veterans' hospital.

If the Government would cease enlarging the veterans' hospitals, which some day will be a white elephant on its hands, and hospitalize in the voluntary hospitals the cases which cannot be hospitalized in the veterans' hospitals, it could save the voluntary hospitals which have through the years borne such heavy burdens. The Government has lent a hand toward saving everything else in the country; why not now consider the plight of the hospitals?

Senator GORE. Do you think the expense of handling these patients in your voluntary hospitals costs the Government as little as it does in the Government hospitals?

Mr. JOLLY. I know that it costs more. The Government accountants do not always do that figuring, they leave that part out of the picture. They do not put in the capital expense or interest or depreciation, and we have to put all of that in. One branch of the Government will put up a hospital and another branch will take care of the patients in there. When they tell you it costs a certain number of dollars and cents to take care of a patient, they leave out the item that comes in from another branch of the Government that puts up the building.

Senator GORE. That does not cost anybody anything, except the taxpayers.

Senator KING. They leave out the capital investment of the Government?

Mr. JOLLY. Yes, sir.

The CHAIRMAN. Thank you very much.

Miss Cathrine Curtis.

STATEMENT OF MISS CATHRINE CURTIS, REPRESENTING, AS NATIONAL DIRECTOR, WOMEN INVESTORS IN AMERICA, INC.

The CHAIRMAN. How much time do you want, Miss Curtis?

Miss CURTIS. I do not think very much, Senator Harrison. I would like permission to read my statement.

The CHAIRMAN. We have six other witnesses here.

Senator GORE. What organization does Miss Curtis represent?

The CHAIRMAN. The Women Investors in America, Inc., 535 Fifth Avenue, New York City.

Miss CURTIS. I appreciate the fact that it is probably the first time a women's organization has appeared before the Senate Finance Committee on the general subject of taxation. I represent Women Investors in America, Inc., the only women's organization of its kind in the country built upon the subject of finance.

We are incorporated to provide a nonpartisan, non-profit-making national agency for women investors, whether they be homemakers, property owners, or wage earners. Our aims and activities are educational and protective.

Thus I come to you not as a tax expert but rather as one in contact with women investors in all walks of life—in many States—who are

both interested and concerned in the welfare of their country, their own economic independence, and the future of their children.

Many women have either voluntarily or through force of circumstances embarked upon money-making careers, but the great majority of women are not money makers—rather they are the conservers—who through self-denial, thrift, and conservation of the family income have laid the cornerstone and builded with their men the firm foundation of American home life, citizenship, and government.

We present to this committee the views of our own members and of countless other women who have written to us from various parts of the country. These women are looking to Congress to put the Nation's house in order to protect the financial status of our Government by insisting that an intelligent, scientific tax program is inaugurated, and by guarding the Nation's pocketbook.

Women are daily becoming more interested in national financial problems. This interest is based on the deep responsibility that they have as guardians and trustees of a vast portion of the country's wealth—wealth of all kinds—insurance policies, savings bank accounts, trust funds, real estate, in addition to over 50 percent of the stock ownership of many of our larger corporations.

Needless to say, these millions of women investors constitute a large proportion of the taxpayers and will be affected, directly or indirectly, by tax legislation which is unsound in principle or inequitable in its demands.

A tax once imposed, even though at a low rate, is usually followed by increase upon increase, and rolls up like the proverbial snowball. A concrete example of this is the Revenue Act of 1913, with its 1 percent rate. This law was superseded in later years by laws with higher rates.

Again, in the 1933 capital stock tax it allowed corporations to place their own value on their assets. They were then allowed to earn 12.5 percent on this value and to pay excess profits of 5 percent above this rate. I understand the new proposals drop this 12.5 percent to 8 percent and apply steeply graded rates above the 8 percent.

Regardless of facts, many people, including many in public life, appear to believe there is a mysterious reservoir of funds from which taxes can be paid indefinitely up to any amount. This is not true. Taxes must be paid from receipts in excess of expenditures in connection with business activities. If there is no excess over expenditures, three sources exist for obtaining tax money.

From labor—by reducing salaries and wages. From investors—by taking it from surplus. From consumers—by raising prices.

Clearly business should be allowed to earn such profits as will enable it to pay reasonable taxes and not be forced to reduce wages, depreciate capital at the investors' expense, or impose too heavy a burden upon the consumer. It is a known fact that high taxes result in unemployment.

Women expect security for themselves and their children and therefore are particularly interested in the insurance and inheritance angle of tax legislation. They must consider the inheritance they receive from their families and must likewise consider the family inheritance to be received by their children.

Let us consider specific figures. It takes \$250,000, invested at 4 percent to yield \$10,000 in income. And while an income of \$10,000

may seem a large amount in small towns, in the larger cities such as Los Angeles, San Francisco, Chicago, New York, Boston, et cetera, the widow with children will find careful planning necessary for comfortable living and educational advantages.

For a widow to have a clear capital of \$250,000 a much larger sum must have been bequeathed because of estate and inheritance taxes reducing the body of the estate and the value of the bequest.

In the case of a widow who, due to taxes, has a smaller amount of capital, either for life or for sole possession, the effect of the taxes is to reduce income for herself and children and necessitates some curtailment in standard of living, educational opportunities, and even may mean a disturbing unsettlement of the family's livelihood and opportunity.

It is our understanding that in the case of the present estate tax, only a relatively small reduction is allowed on account of insurance. It is also our understanding that under the proposed inheritance tax in the House bill, there is no allowance as against the tax, because of insurance. This will mean that a husband cannot effectively insure against Federal death taxes.

It would seem that in furtherance of thrift, in the interest of the Government, and as a matter of fairness to women and children of the country, some provision should be made to permit a husband, during his lifetime, to pay from income whatever premium charge may be necessary to buy insurance which will be sufficient to cover these heavy death dues that will be charged against his estate.

This would be one method of avoiding the depreciation or perhaps entire loss of income-earning properties. It is our understanding that in Canada, for instance, the proceeds of such insurance policies, payable to an estate or to an executor, for the purpose of meeting death taxes, is completely exempt from tax unless there is a surplus over the amount of tax, in which case only that surplus is taxable.

Senator LONERGAN. To what extent does the exemption apply?

Miss CURTIS. May I finish reading my brief?

Senator LONERGAN. Yes.

Miss CURTIS. Thank you.

We believe that families should be able to insure against the damaging levies of death dues upon their livelihood, just as they insure against death, fire, tornado, et cetera.

By provision of such tax-free insurance—limited if you like—for the purpose of death dues—an insurable man sacrifices present income in order to make a plan of investment for his family before his departure. Without it he cannot be assured by any form of will or bequest that taxes—shrinkage of value—general business conditions—heavy administrative costs of his estate will not defeat his plan and make his loved ones dependent upon others and deny them adequate educational opportunities. The principle applies alike to large and small estates.

Money that is not constructively employed, that is not capably managed, disappears. Even wealth that is represented by tax-free investments or other securities with protection of principal and low yield, is serving a social purpose if it means, as in the case of widows and children, a continuity of family life on a reasonably high plane.

This is not an objection to the proposal to prevent tax exemption but is an emphasis upon the idea that women investors or those

women who come into the possession of property through inheritance have the same problems of remunerative employment of money—even though they may not be actively engaged in a business or profession—that confront the men.

I have a dear woman friend who is in business. She is responsible for the support not only of her two children but of her parents as well. She carries \$300,000 of insurance and deprives herself in order to build for their security and protection in the event of her death. Under the new proposals she realizes that she would be making these sacrifices with no assurance that the Government taxes would not defeat her plan. The result would be that a large portion of her thrift and sacrifice would go to the support of Government expenditures about which she may have serious question as to the advisability.

The words "reckless spending" by Government—Federal, State, and local—are often heard in the conversation of women of the type that I represent. My friend, of whom I have spoken, thinks it unfair to her family—unfair of the Government and in the event this legislation is passed she intends to cash in her insurance policies and relieve herself of the yearly premiums she has been paying. Her situation is undoubtedly duplicated by thousands of other women and men.

This unquestionably penalizes thrift, takes money from the insurance companies, which represent capital reserves, and is a step toward a lower standard of living.

When people realize that it is useless to save or amass a reasonable competency, that less individual effort will be allowed, their conscience or code of ethics will deteriorate. Producers will become drones and as citizens their interest in the support of government and civic responsibility wanes.

Women own a major portion of the stock of many large corporations which, because of their able management and diversification of risk, offer women investment security. Is it fair to impose upon these women the principle of a more burdensome tax because they have invested for security than might be imposed upon smaller corporations offering them less security for investment?

The mere possession of assets by individuals or corporations, if called wealth, does not necessarily mean income. Mainly, payments to the Government must come from earnings, and whether taxes on corporations are called corporate taxes, excess-profit taxes, capital taxes—they are inevitably taxes.

I have attempted to develop the idea that heavy corporation, excess-profits, and capital-stock taxes upon business, that exceedingly high inheritance tax rates, that very large surtaxes upon individual incomes will have a reaction upon women investors who now represent such a considerable proportion of wealth that is actively employed in industry and commerce.

Because of women's interest in government, in social progress, she desires order in government operations, especially those affecting its finances, as keenly as she desires such order in her own home.

Senator KING. She is expecting too much.

Miss CURTIS. She decries tax programs that strike at large corporations, or large individual incomes or large inheritances, simply because they are large, and that are put forward as the basic reason

for high rates. These programs do not now and in my judgment never will appeal to the reasoning of women.

Taking the program as a whole, or as outlined in the House bill, it appears that the proposed taxes are designed to affect mainly taxable years after December 31 next. Therefore, Congress will not produce revenue for the Government in the current fiscal year ending June 30 next, and will produce revenue only in part for the next fiscal year.

Mothers of the country are worried, for they are beginning to realize the tremendous burden of debt which will of necessity have to be passed on and borne by their children, and I know that women generally are frightened. They fear matters of great importance are being enacted in a hasty and illadvised manner. They deplore the fact that tremendous subjects are being rushed through under such conditions as suggest poorly conceived legislation.

Women are perfectly willing to pay a reasonable proportion of the Government tax bill, but they desire that the bill itself be reasonable and so devised that it will be in the general economic interest of all and not disastrous or destructive to the interests of many.

The House tax bill has been in our possession for only 48 hours' time. It deals with a serious and important subject, intricate and involved. Nothing would be lost to the Government if the Congress of the United States took adequate time and gave the citizens of the country sufficient opportunity to understand and express their opinions on these tax proposals, and delayed consideration of this act until next January when the Budget will be under consideration.

Women are young in financial knowledge, they have much to learn and to understand, but one thing is certain: Because they have so much at stake they are determined to tackle these important problems and to lose no opportunity to broaden their financial understanding and inform their Representatives in Congress of their views.

It is the spark of ambition, combined with initiative and the savings of millions of people, which is responsible for the tremendous progress and success of American industry.

On behalf of Women Investors in America, I make a plea to Congress, through this Senate Finance Committee, to not only function in accordance with its constitutional rights but to delay this legislation until January and to assume the responsibility of seeking to bring about a sound financial program for our Government, based upon balanced taxation and intelligent expenditures.

Only in this way can our women find peace and happiness in their homes and a reestablishment of security and confidence in their government.

Senator GORE. I am impressed with what you say, particularly in regard to making provision by way of insurance, but I wish you would state your criticism a little more distinctly and what you want us to do to provide that security for women.

Senator KING. She wants to postpone action until the first of January, which I believe is a very sound suggestion.

Senator GORE. I do not believe that it is practical, however wise it might otherwise be. I did not quite get your point about making provision by insurance for the payment of these death dues, what you want us to do to meet that suggestion.

Miss CURTIS. Of course, Senator Gore, as I said before in opening my talk, I do not come to you as a tax expert. Our members realize and I realize that taxation is a matter of years of study, but we do feel the insurance angle is vital to women, and nothing should be done to jeopardize their rights or to destroy their capital.

I would say, in a direct answer to your question, that it should come only after study from an expert, but I, of course, have tried to base my words upon the broad principle.

Senator GORE. I would be glad to have further information as to the detailed method of carrying into effect what you suggest.

Miss CURTIS. I will be glad to supply you what I can.

Senator KING. I think generally her proposition involves not taxing the money which is expended by the man or the woman for insurance policies, that they should receive a deduction from their aggregate earnings for the amount which is devoted to that purpose; and, secondly, if I understand the lady, that the taxes ought not to be upon inheritance taxes such as to be confiscatory so as to deprive the women and children of a reasonable amount which the husband has anticipated they would have upon his demise.

Senator GORE. Here is the point: I was wondering if she wanted a general exemption from taxes of moneys devoted to the payment of premiums on insurance, or whether it should be allocated and set aside as a special fund for the payment of these taxes.

Senator LONERGAN. I am in sympathy with the views expressed by you. To what extent does Canada give exemption to the proceeds of life-insurance policies?

Miss CURTIS. I believe there is one part of Canada—I don't know that I can tell you exactly—I think it is Alberta, that gives exemption.

Senator LONERGAN. Do you mean an entire exemption?

Miss CURTIS. I think it is an entire exemption, or it may be an exemption up to a substantial amount.

Senator LONERGAN. Mr. Parker, our tax expert, told me the other day that under existing law there is an exemption of \$50,000 on the proceeds of policies paid to estates and an exemption of \$40,000 on payments to individuals.

Miss CURTIS. In Canada?

Senator LONERGAN. In the United States.

Miss CURTIS. I was speaking of Canada.

Senator GORE. Do you mean the proceeds of insurance policies or the premiums paid on insurance policies?

Senator LONERGAN. My understanding is that it is the proceeds payable to an estate up to \$50,000, that under existing law, it is exempt. And payable to an individual up to \$40,000, it is exempt.

Miss CURTIS. That is true.

Senator LONERGAN. I am in favor of exemptions of proceeds of life-insurance policies up to a certain sum.

Senator KING. You may elaborate your views and submit them as soon as you can.

Senator GORE. Your organization is located where?

Miss CURTIS. National headquarters of Women Investors in America, Inc., is at 535 Fifth Avenue, New York City. It is incorporated under the laws of the State of New York. It is a nonprofit and non-partisan organization, and it is interested in educational and protective activities. We are not a financial counseling organization. We do

not give financial advice. We do seek to educate American women on financial fundamentals, upon the principles of investment, and to offer them a protective medium.

Senator KING. Thank you very much.

Miss CURTIS. Thank you very much for giving us the opportunity. (The following data were subsequently submitted by Miss Curtis:)

APPENDIX TO STATEMENT OF CATHRINE CURTIS FOR WOMEN INVESTORS IN AMERICA

(Presented for the record of the hearings, before the Finance Committee of the United States Senate, upon revenue proposals)

In addition to the remarks on the Revenue Act of 1935, presented by me on August 2, it is our opinion that the provisions set forth should be incorporated in some form, for the following reasons:

1. We consider it inequitable and possibly unconstitutional to tax proceeds of life-insurance policies on a decedent's life where someone other than the decedent has helped the decedent pay the premiums. Where such is the case only the amount of proceeds in proportion to the premiums paid by the decedent should be considered as an asset of his estate, as recognized by statutory provisions in the succession duty acts of Canada.

2. Where the rights of ownership in an insurance policy are relinquished by the insured, the proceeds of such insurance are no longer a part of his estate and it is unconstitutional to tax them as such. In further support of this contention, it is important to remember that such transfer is taxable under the present gift tax law and also under title 3 of the proposed Revenue Act of 1935.

3. An individual should have the right to insure against shrinkage of the value of his estate by levies of death taxes and against losses instituted by forced sales, on account of nonliquidity, to meet payment of death dues, just as he has the right to insure his property against destruction by fire or other destructive forces. Where an individual has exercised this right and laid aside a portion of his income or assets during his life, in order to effect security and protection for his family, upon his death, such insurance should be earmarked and set aside for the payment of death taxes and should not be considered an asset of his estate, unless such special insurance is more than the amount of the death dues. This would protect beneficiaries from shrinkage by forced sales, necessitated by nonliquid assets. It would insure the Government of immediate payment of taxes imposed and eliminate all costs of enforced collection.

I submit the following in support of our statement:

EXCERPT FROM ALBERTA SUCCESSION DUTY ACT (CH. 17, SEC. 7, LAWS 1934:24 GEORGE V) EXEMPTING LIFE PROCEEDS EARMARKED FOR PURPOSE OF PAYING ALBERTA SUCCESSION DUTIES

"7. No duty shall be payable on or in respect of—

* * * * *

"(e) Insurance moneys, being the amount of any life insurance policy effected by a deceased person on his life, and expressly earmarked for the purpose of paying duty imposed by this act, except as to any excess of those moneys over the amount of the duty."

EXCERPT FROM NEW BRUNSWICK SUCCESSION DUTY ACT (CH. XII, SEC. 6, LAWS 1934:24 GEORGE V) EXEMPTING LIFE PROCEEDS EARMARKED FOR PURPOSE OF PAYING NEW BRUNSWICK SUCCESSION DUTIES

"6. No duty shall be payable on or in respect of—

* * * * *

"(f) The amount of any life-insurance policy or policies effected by a deceased person on his life and expressly made payable to the Treasurer or an executor or trustee for the purpose of paying duty imposed by this act, except as to any excess in such amount over and above the amount of the duty, which excess, received by the Treasurer, shall be accounted for by him to the person entitled thereto."

* * * * *

4. The levy if inheritance tax is based upon the principle that the sovereign power has granted to those under its jurisdiction the right to receive property from another at this death. Therefore said sovereign power has the right to demand a portion of property so received for the granting of such privilege. We do not believe, however, that an individual's other assets should be jeopardized or made subject to a lien for the collection of such government levy.

Personal liability of beneficiary under section 210E states: "If the tax is not paid when due the beneficiary, subject to tax shall be personally liable for such tax." For example: A widow might receive from her husband at death real estate or assets which might have no present market value. She might be without cash to pay the Government tax. However, she might have property of her own such as an insurance policy to provide for her support in her old age. This personal property should not be subject to a Government lien for payment of death taxes, as might readily be done under the provision for personal liability of a beneficiary as quoted in the proposed act. In our opinion the basic tax principle involved demands that only the property received by the beneficiary shall be subject to a Government lien for the enforced collection of the tax.

I have requested Jean Nelson Penfield, general counsel for Women Investors in America, Inc., to suggest amendments to this tax bill and submit them herewith for consideration.

The testimony presented before the committee by various experts has been most enlightening as to this hastily drawn and un-American legislation. If enacted into law it will add additional burdens to industry, appropriate the capital of individuals to the point of confiscation and increase economic insecurity. It will be a drive against the fundamental principles of success and security—against the right of individuals to earn in accordance with their ability. Women do not want to limit their families' future or that of their children to Government courtesy rather than merit. We again appeal to this Senate Finance Committee to delay this unnecessary legislation until January and at that time to enact a tax program to produce revenue rather than litigation.

AMENDMENTS TO THE PROPOSED REVENUE ACT OF 1935, SUGGESTED BY MRS. JEAN NELSON PENFIELD, GENERAL COUNSEL FOR WOMEN INVESTORS IN AMERICA, INC.

For Section 203, subdivision 7, substitute the following:

Insurance.—The receipt by any person of the proceeds of insurance under a policy taken out by the decedent upon his own life where the policy was wholly kept up by him or of a part of the proceeds of such insurance in proportion to the premiums paid by decedent where the policy was partly kept up by him, provided the decedent retained the right to change the beneficiary or any other legal incident of ownership in such policy.

Proceeds of an insurance policy taken out by a decedent upon his own life, payable to his estate in trust for the payment of estate, inheritance, succession, legacy or any other death tax levied against or with respect to the estate of decedent by the United States or by any state or territory of the United States, or by any foreign government, whether such a policy was originally issued or subsequently indorsed, for such purpose, received by the executor of the estate and applied by him in payment of the aforesaid taxes, are hereby specifically earmarked and excluded as receipts by reason of the death of a decedent and shall be exempt from the tax imposed by this title.

For Section 210, subdivision (e), substitute the following:

If the tax is not paid when due, it shall be a lien against that property only with respect to which the tax is imposed.

NOTE.—It is suggested that the word "receipt" be used throughout Section 203 for the word "transfer" to effect consistency with the principles of inheritance taxation.

Senator KING. Mr. H. E. Miles, of Washington.

Mr. MILES. Yes, sir.

Senator KING. How much time do you want?

Mr. MILES. I will try to make it very brief.

Senator KING. I wish you would because we have three or four more before 12 o'clock. Proceed.

STATEMENT OF H. E. MILES, WASHINGTON, D. C.

Mr. MILES. Mr. Chairman and gentlemen, I am not much concerned with any one rate in this bill, but I think I have a suggestion for getting more money, and many of the identical dollars that you are seeking by a little broader consideration.

I wonder how many people will realize that the people of the United States paid in their national capacity last year 13 billions of dollars in taxes? I don't know of any figure used except that the Federal taxes were 4 billion. The tax paid in the national capacity by the people of the United States as near as can be figured was 13 billion. This is the way we pay the 13 billion. I show the items in a table I now hand the stenographer.

(Information referred to is as follows:)

The Federal tax system, fiscal year ending June 30, 1935

	Column A. In the 1920's	Column B. Actually levied year ending June 30, 1935
For ordinary current expenses, the "budget", about.....	\$4,000,000,000	\$4,000,000,000
Private taxes, privately levied, privately used.....	4,000,000,000	¹ 3,000,000,000
"Equality for agriculture." Aimed at, not realized, attempts disastrous. Increase in prices at the farms \$4,000,000,000 costing consumers.....	8,000,000,000	² 6,000,000,000
Aimed at, not collected.....	16,000,000,000	³ 13,000,000,000
For total tax expenditures add \$4,000,000,000 "deferred", borrowed from banks for relief, public works, boondoggling; to be levied and paid with interest as soon as the public can stand it.....		4,000,000,000
Total Federal taxes, 1934, including "deferred".....		17,000,000,000
For total public taxes add State and local.....		6,000,000,000
Total taxes of America people, including \$4,000,000,000 "deferred" (not including "deferred" taxes spent by States and municipalities).....		23,000,000,000

¹ Depression.

² Agricultural Adjustment Administration.

³ Actually collected.

The above \$6,000,000,000 Agricultural Adjustment Administration taxes were (Agricultural Department Aug. 1, 1935) \$594,000,000 in benefits paid farmers, year ending June 30, 1935; \$931,000 increase above 1932-33 in receipts from sales; \$1,000,000,000 increase in inventory values at end of year to be realized if prices hold; and an enormous but uncertain sum from crop reductions, pig slaughter, etc., that kept the 1933-34 sales from dropping possibly to the lows of 1932, when eggs in Midwest towns were 5 cents a dozen to farmers, corn 12 cents in Iowa, and wheat 15 cents. There would have been no bottom, say some authorities.

The private taxes levied by the trusts, \$4,000,000,000 per year in the 1920's, were the excess charges, sales taxes, added to prices by only part of the criminal trusts, and not including another \$4,000,000,000 in consumer prices that they added under the principle of protection to home industries, wage earners, etc. This first-mentioned and excess \$4,000,000,000 was contrary to the antitrust acts; the Constitution; the common law; the commandment, "Thou shalt not steal"; and Christ's new commandment, "The strong shall have compassion for the weak."

We all know that the budget was about 4 billion and for 20 years, some of the ablest men in the Senate and others have participated in determining as near as possible the private taxes privately levied for private uses by people called "trusts" and criminals in terms of the law.

You cannot figure that at less than 2 billion dollars levied by 60 only of the many trusts, utterly beyond the law, a government within the Government, 2 billions that cost consumers 4 billions. I can give you the references where you can get the figures and you will see they are extremely complete.

Senator KING. You refer, I suppose, to the high tariff rates and so on?

Mr. MILES. Not so much the tariff. The tariff was simply a barrier that kept things out and let these people behind the wall do as they choose; but today we have other barriers, and we can forget the tariff.

Senator KING. You mean domestic monopolies?

Mr. MILES. I mean domestic monopolies. Congress has done marvelous in enacting legislation against those monopolies. It has imposed penalties in the form of fines, confiscation of property in transit between States, imprisonment, trebled damages, and all of that. The punishment is the greatest that I know of except for murder, where they hang.

So it need not be questioned whether these charges are proper or not. In 60 industries only they totaled through the twenties, 2 billion dollars, costing consumers 4 billion.

Then came, gentlemen, what I call the "dance of death." Let me finish first—no, all right—the "dance of death."

I was extremely close to farm organizations and represented at one time 80 million business men all in this movement against private taxation.

Senator GORE. You don't mean 80 million?

Mr. MILES. Eighty thousand. Now, maybe a million and a half farmers and 600,000 wage earners.

Senator KING. You must have read Havelock Ellis, *The Dance of Death*.

Mr. MILES. I read some of his books.

Senator KING. They are all fine.

Mr. MILES. But I did not know of his *Dance of Death*.

This 4 billion was passed on by city people from one to another by increasing living expenses until it reached the farmers. And the disparity in farm prices was just that 4 billion dollars. They started out for equality for agriculture, and if this is not the "dance of death" I will withdraw the statement.

Everybody knows that the farmers must have equality, and everybody knows they are going to have it. Fifty million people on farms and small villages are not to be trifled with, they cannot be trifled with.

Well, we saw the defect. I went to them and to many editors and economists. They could have gotten equality if they could have gotten the Federal administration and Congress to remove this 4 billion of private taxation, but they felt that it was perfectly useless to try to do it and they were dying. They had to take strychnine if necessary, a poison, but the best remedy for a heart that is about to stop.

They would not try to remove this private taxation, so they tried to get even with it, equality with thieves though not in intention, equality with that 4 billion dollars of private taxation that in the end fell upon them, as was said by John R. Commons and Melville Traylor, of the First National Bank of Chicago, and men of that

character. To get even with that 4 billion they had to add 4 billion to the prices at the farm, and that meant 8 billions to consumer prices.

So I add to the 4 billion budget the 4 billion of the private taxes, and 8 billion of "equality" taxes that they aimed at in the twenties, and 6 billion of that collected in the year ending June 30, 1935, pretty much according to the disclosures in yesterday's bulletin from the Department of Agriculture.

Senator GORE. What bulletin?

Mr. MILES. I was at the Department of Agriculture with one of its best economists and saw the stencils, and I saw those figures. It was to be released August 1. I don't know what it is called.

Whether the A. A. A. costs full consumers 6 billions or not, it is short of parity by a billion and a quarter. The Agriculture Situation in the last issue says that they are 82 percent of parity. That means they have to add another 1 billion dollars to farm prices and 2 billion to consumers.

Senator GORE. Are the figures 2 for 1?

Mr. MILES. Yes. The time was when the farmers used to get about one-third of the consumer's price. In perishables sometimes they scarcely made their freight back.

I was with a marvelous farm leader in Nebraska 6 months ago, when he said to a superintendent: "If anybody wants a hog, give it to him. They are worth nothing to me."

Anyway, the Department of Agriculture shows that the farmer gets half of the consumer price. Here is the "Dance of Death." When you add 6 billion dollars to the cost of farm products, the 4 billion of private trust taxes has to go up. The part of the 6 billion that goes into wages and production and so forth, is doubled, so if 2 of the 6 billion reaches industry, it reaches consumers through industry, as another 4 billion.

I hand the stenographer a chart for inclusion at this point, as follows:

THE DEFECT IN THE NATIONAL TAX SYSTEM

Private Taxes—Privately Used
"Equality for Agriculture" as attempted in the 1920's
and largely realized in 1935.

A	B
Levied by Manufacturers of Trust Products (Including distribution costs) \$4 billions (1927 basis)	"Equality" for Farmers (Including distribution costs) \$8 billions

Read from bottom up

Cost to consumers at retail \$4 billions
Levied by only 60 mfg. trusts (Others not estimated) \$2 billions

Equality

Cost to consumers \$8 billions (\$6 billions realized in 1935—\$2 billions more to get.)
"Equality for agriculture" "Parity prices" \$4 billions to add at the farms \$3 billions realized in 1935—one more veto to add

The care with which above column A was calculated on 23 billion dollars of trust products and thousands of surprising details, the distribution among industries, the effect upon wages, retail prices, foreign trade, etc., is shown in the statements inserted by Senator Norris in the Congressional Record of January 23, 1930, covering 26 metal industries, and by Senator Norbeck March 5, 1931, covering 34 classes of general store merchandise. The two analyses cover 23 billion dollars of factory merchandise. There are many lesser analyses, including the effect upon various States, in the Record for the years 1929 and 1930, probably indexed under my name or the Fair Tariff League. They are a compelling exhibit of the evils of private taxation. The effect upon the South and other States, inserted by Senator Harrison February 25, 1930. Wage-earners etc., Senator Wheeler, January 11, 1930.

The studies of the 60 industries do not include such secondary levies as the 400 million dollars added to automobile retail prices, because of the extra cost of trust-made materials; the more than 400 million dollars added to freight and passenger charges; 70 million dollars to cement; 110 million dollars to farm implements; the sugar problem of 300 million dollars, and a host of like charges. The investigation was not meant to be complete. It showed a net loss to the South of 1¼ billion dollars in 1927; to Iowa 119 million dollars, to Iowa farmers 39 million dollars; to Washington 77 million dollars; to Washington farmers 11 million dollars, etc.

Incidentally, the Interstate Commerce Commission is chargeable with laxity close to dishonesty in permitting our railways to be overcharged in their purchases. I sympathize with their probable reply that they are too weak to be the only honest folk in this field; that honesty like the Federal Trade Commission's is too difficult for ordinary men.

Nine billion dollars is a huge sum for any nation to endure in taxes not taken for the public use. The studies already made show the devouring evil of it all. None can be too busy to delay consideration. What else cannot better wait.

Better save the poor 9 billion dollars than soak the rich 270 million dollars.

I think everybody pretty much knew back in the twenties that it was a "dance of death," that you cannot have these two columns one against the other. They had a furniture display in New York reported in the New York Times. Furniture is retailing at 70 percent above the factory price, and just because at this great national display buyers disclosed interest, it was decided to raise the price another 5 percent, which means 8½ percent more to the consumers.

We cannot keep one column down if you have the other column operating. And the poor laboring man—when I went into the Department of Labor last summer, the poor laboring man was a pretty fair illustration of the rest of us. He had had his wages raised 30 percent and he was 11 cents a week worse off than before he got his 30 percent increase.

Senator GORE. Where did you get those figures?

Mr. MILES. The Department of Labor statistics.

Senator GORE. Do you know what bulletin it was?

Mr. MILES. They were making a complete study, and I the figures they had at hand.

We all know that labor is not getting any advantage. As part of the dance of death, we are crazy for price increases. I never imagined that civilization could go dippy on mere price increases. When all prices are increased 30 percent, no price is increased a penny.

As an illustration, there is the laboring man I have just spoken of. We have gotten our prices so high that people cannot buy. We have a kind of a revolution on, and the end is not yet, the dance is not done. The people who advised me, great editors and economists who believed in the method used to get equality for agriculture said, "Miles, it won't work, but it will raise so much hell that something will happen." I think you gentlemen must have heard that statement yourselves.

Now we are right there and the devil is to pay.

Senator GORE. Have you referred to a consumers' strike or something like that?

Mr. MILES. The consumers cannot buy. They have too much sense to buy. Cement costs 50 cents a barrel first cost with good practice. It retails for \$2.30 to \$2.90.

Steel—we used to be the cheapest producer of steel in the world. I don't know whether we know how to make steel any longer. When a man told me last summer that bar steel was selling for 57 cents a hundred pounds, at European ports, I said, "It is ridiculous." Then I phoned the Bureau of Foreign and Domestic Commerce and one of the steel experts said, "Well, you know, Miles, in Belgium steel is a byproduct." I nearly broke the telephone and he choked. He said, "I don't just mean that, but a sort of a byproduct. They use what we call byproducts to such tremendous advantage."

I use to buy steel for 80 cents. It is \$1.80. And a lot of people, as Mr. Gary, Mr. Schwab, and the rest of them, always said, "We can make steel cheaper than anywhere else in the world," but steel and other trust prices are now so high that we have got to go and hide. We are like a sheep seeing a wolf with his nose in the door when any foreigner offers us a little material.

Senator KING. While we might agree with that philosophy which you are expounding, namely, that high prices will insure prosperity, nevertheless we have a tax bill before us now, and anything you can submit with reference to the tax bill we shall be glad to have you proceed on.

Mr. MILES. It seems to me that with 13 billions of taxes paid last year, not including 6 billions of State and local taxes, making 19 billions, and not including the 4 billions that was borrowed from banks and will be added to the tax roll, the thing to do, instead of patchwork legislation—we can do what a very great and world-famous French financier did a little while before the French Revolution. He reformed the basis of taxation, he arranged for a better distribution of wealth, he developed enormous new fields. Here are 13 billions of private taxes that are unlawful, probably. In heaven's name, how can you hunt up somebody that has a little money or is about to die when the real job is this 13 billions?

Senator KING. We have not got a French king back of us to help us.

Mr. MILES. That man was finally ousted by the predatory rich and for want of him the king soon lost his head.

Senator GORE (interposing). Mr. Miles, I think you are mistaken about the amount of taxes.

Senator KING. He referred to the indirect as well as to the direct.

Senator GORE. I understood that. As I understand, the total expenditures of all of our governments, National, State, county, and city, and all combined aggregate about \$14,000,000,000 a year.

Mr. MILES. Ten billion, they told me at the Treasury yesterday.

Senator GORE. No. The taxes levied to pay these expenses amount to a little less than \$10,000,000,000 a year. The difference is made up nowadays by borrowing credit.

Mr. MILES. I was astonished to hear that States and municipalities increased their debts only \$309,000,000 last year.

Just a word as to reaching these swollen fortunes.

A rather general desire to "soak the rich" comes from a hatred of stolen fortunes, in which hatred I share. I submit that the way to prevention is to stop their accumulation by enforcement of the anti-trust acts and possibly other measure. I submit that the pending bill is undesirable in that it permits the continuing accumulation of these fortunes and only seeks to recover a small part of them in inheritance taxes.

Those who amass wealth by dishonest practices are cruel and very often are brutal. Their brains are in their fists. They are big spenders. They take great risks. Many of them who steal, say, 40 millions, die with only 20 millions. The present bill would secure, say, half of this 20 millions and would give that to the Government for its proverbially loose spending. How much better to stop the accumulation of these fortunes and thereby leave the suggested 40 millions in the hands of those who earned them, thereby affording, on the whole, a basis of billions for new taxation annually.

Senator GORE. Do you have some concrete suggestions as to how we may amend our trust laws or other laws so as to prohibit these trusts?

Mr. MILES. The trust laws are perfect, but they are not enforced. I would like simply that the laws of the United States shall be enforced.

Senator GORE. That is the point.

Mr. MILES. It is a question whether Congress will get the laws enforced.

I believe in Ford's as much as anybody. I think you had better leave Ford's money with him. I think he will use it better than the Government will. That is an honest fortune. But the swollen fortunes that excite public resentment are those others I have spoken about.

If the Federal Treasury, which is not economical, gets 10 millions out of the 40 millions stolen, that is wasteful. By the method of stopping those enormous private taxations, you would leave that whole 40 billions in the hands of the people who earned them. You would develop tens of billions of new sources of revenue if you would enforce these laws. Congress can compel their enforcement.

Mr. MILES. I thank the committee for its gracious courtesy.

Senator KING. Mr. Edwin Hawes, Jr., Wharton, Tex.

Mr. HAWES. Yes, sir.

The CHAIRMAN. How much time do you want?

Mr. HAWES. I can read my statement in about 15 minutes or possibly 20.

Senator GORE. What phase of the subject are you going to discuss?

Mr. HAWES. I am going to advocate the amendment of a graduated corporation income tax.

The CHAIRMAN. Get through as quickly as possible, because we have to close the hearing, and there are two more witnesses this morning.

Mr. HAWES. I am unfortunate in the fact that the time is so limited. I think, though, that as the only one appearing in favor of the graduated income tax on corporations, that I have heard in these hearings, that I, at least, ought to have some consideration, because I am appearing as a witness in favor of that kind of tax.

The CHAIRMAN. Proceed.

STATEMENT OF EDWIN HAWES, JR., WHARTON, TEX.

Mr. HAWES. I appear, Mr. Chairman, in the capacity of a private citizen. I represent no organization and no association.

I appear in what I conceive to be the public interest and no other. I own or control some three-quarters of a million dollars of property of which \$40,000 is stock in 12 corporations running from the Gulf Oil down to the local banks; \$25,000 in cash, \$40,000 in mortgages, bonds, and notes, and the balance in real estate, farm, and mineral properties.

I believe it is a fair statement that justice in taxation requires that taxpayers having identical character of property and income be required to pay the same rate and amount of tax.

Again if any favors should be granted they should inure to the individual as distinguished from a corporation. But strange as it may seem, a system of income taxation has grown up in this country by which the corporation is now and has been for more than 20 years favored and discrimination made against the individual.

It has been long well established by the courts of the States (115 Tex. 417) and by the United States Supreme Court that a corporation is to be regarded as a *person* within the meaning of the law and thereby receives the privileges, protection, and rights provided by the law and Constitution. A corporation is regarded as a *citizen* of the State where it is created (12 Wall. (U. S.) 65).

If it is entitled to the privileges of a citizen, in the name of justice, why should it not be taxed equally as much and on equal terms with a citizen?

Yet here is a comparison as to a net income of say \$200,000 under 1934 Federal rates:

Tax of an individual taxpayer.....	\$87, 490. 50
Tax of corporation plus capital-stock tax.....	30, 000. 00
<hr/>	
Amount individual pays in excess of amount paid by corporation.....	57, 490. 50

Thus it appears that under our present law on a net income of the amount above mentioned the individual taxpayer is required to pay nearly three times as much as a corporation on the same amount of income. The injustice is so apparent as to need no further demonstration.

It is purely a legal fiction to argue that the company and its stockholders are identical. The average small stockholders have no more to do with the actual conduct of a large corporation than an outsider. The only real privilege he has is to sell his stock; otherwise he is practically ignored in the corporate affairs.

It has been many times stated by the agents of large industries appearing before this committee that a graduated income tax on corporations will be discriminatory. To my mind it is sufficient answer to point out, that as corporations enjoy most of the substantial privileges and rights as are enjoyed by a person, they should likewise be required to assume the burdens and responsibilities of a citizen in tax matters. As persons have borne graduated income taxes increasing as the amount of income increases, since 1913, I think it comes with ill grace that corporations ask that their present privileged position be perpetuated.

Corporations should be treated with equality before the law but not with favoritism.

The suggested maximum rate of 16¼ percent, which is one-sixth of net income, appears extremely moderate and modest as compared with the approximate 43 percent on an individual net income of the amount mentioned.

If a graduated income tax on corporations is a penalty on bigness, it has been for nearly a generation a penalty on "bigness" of the individual taxpayer.

The statement so often made that it will be a high rate of tax on low incomes of large corporations and a low rate of tax on small corporations with large incomes, applies equally as to individual taxpayers under the present law, and there is nothing new in it, unless the corporate taxpayer is to be continued in its present favored status.

In the market place, in the courts, and in all competitive business or activity the individual citizen has to compete and deal with the corporate entity as another person. It appears to me quite unfair to perpetuate a system of continually placing heavy burdens on the individual citizen from which the corporation is relieved.

Again it is said the graduated tax will work hardship and injustice on millions of small stockholders in large corporations. May I suggest all taxation works hardship in exceptional instances. I say exceptional because I believe that 85 percent of the corporate stock of the Nation is owned by less than 20 percent of the people, and large stockholders as a class are in a much better shape to bear tax burdens than the masses against whom they are continually urging the general sales tax, a tax on poverty, not property.

I think it true that nearly all general legislation has a social aspect in a broad sense, as the object is to benefit the general welfare. We should not therefore condemn the graduated corporation income tax proposal because it may be of general advantage as well as a just revenue raising measure.

It is believed all thinking men will agree that one of the main objectives of government is to establish equality of opportunity. Concretely that the present and oncoming generations shall have some chance to engage in some line of endeavor or business with as much independence and freedom from restraint as may be obtainable and to successfully continue this status. Not merely to get a job but to own a business.

It is equally true that as the size of an industrial enterprise increases that the rules and restrictions of the conduct of the workers increase. Each and every rule of conduct required of its workers by an industry has to a degree the effect of displacing or withdrawing from the worker his freedom of action and independent conduct.

Thus with the increase in the size of industrial enterprises there has been a great decrease in the freedom and independent thinking and conduct of the citizen. His sense of loyalty to his employer and necessity to obtain his salary and sustenance for his family has almost diminished to the vanishing point his sense of duty to act for the public welfare and for the maintenance of a fair and impartial government.

It is my idea that one effect of a graduated corporation income tax will be to encourage the maintenance of comparatively small corporations or industrial units, and by the same token discourage the merger consolidation and expansion of companies to unwieldy proportions.

The profit motive is usually the sole objective of business corporations. If it is more profitable to operate small corporations than large, our business men will quickly decentralize the larger concerns into smaller ones; or owners of business enterprises operate their own business.

We should by all means available bring management and ownership closer together. The ideal condition is for an owner of property to conduct it himself rather than through corporate agents. An individual conducting his own property is at all times subject to the responsibilities of ownership; he must maintain moral and charitable and religious standards and meet the duties of citizenship and thus temper the profit motive. Whereas in the large corporate entity the corporate agent intent only on showing a profit from the conduct of the enterprise is to a degree devoid of similar civic responsibilities.

Frequently those who conduct its management are thousands of miles from the place the business is conducted. Recently our city had to acquire a small tract of land fifteen feet square from an oil company. There was no one authorized to make a decision closer than New York, some two thousand miles away.

There are a great many people in this country who think it is time to attempt to aid and preserve the smaller units in industry. A graduated corporation income tax will have a tendency to discourage the creation of further chain stores of every character, and in general discourage the operation of large unit industries by non-resident owners, thus giving the citizens of each community some opportunity to carry on a business as an owner and not merely as an employee taking orders and obeying rules sent out from some distant city.

As a matter of fact, however, the moderate maximum tax rate of 16½ percent proposed will not discourage the creation or maintenance of large corporations and will have no appreciable effect on their conduct or size.

As a final thought, I wonder if Congress would be pestered by the multitude of lobbyists now here if corporations were smaller in size.

Would there be the brazenness as was shown in the Tea Pot Dome scandal, the Fall-Sinclair episode, the granting of favors and gratuities by the Morgan partners, the spending of more than a million dollars to defeat one proposed law, and the more recent and more serious pollution of the source of communication of the constituent with the Members of Congress by the sending of false telegrams as shown in the lobby investigation? I think not.

Mr. Chairman, I would like to call to the attention of the committee the fact that no later than in yesterday's paper it appeared they have gone further than anything I have mentioned, they have undertaken to undermine the personal character of our President, for whom I have the greatest admiration.

I find in yesterday's paper that one of the gentlemen of the utilities corporations, one of the largest in the United States, has undertaken to undermine the character, the mentality of our great President. I think, if the chairman please, if we have smaller corporations, I know in my own community, we would have no idea of doing any such thing.

The CHAIRMAN. You think the whispering would be less?

Mr. HAWES. We have no whispering. We have great respect for our President, and I think that such things are—

The CHAIRMAN (interposing). I think you are absolutely right. We are familiar with what has happened on that.

Mr. HAWES. I would just like to get those remarks in. There have been so many remarks on the other side, and statements that corporations have been discriminated against when as a matter of fact it has been just the opposite; the individual has been discriminated against. Eighty-seven thousand dollars tax on an individual against \$30,000 on a corporation.

It is not fair to say that the corporation is the same as the stockholders, because there is no more relationship between the stockholders and the corporation than there is between a child in a family and the father of a family. In the modern corporation, the stockholder has nothing to do with the management of the corporation. He only gets a proxy once a year; he does not know how much the officers are being paid and he cannot get the information. There is no relation between the stockholder and the corporation except that he gets dividends if they declare them, and he can only sell his stock.

The CHAIRMAN. The committee is obliged to you for your information.

Mr. Julian D. Conover?

A VOICE. He is on his way up here from down town.

The CHAIRMAN. Mr. Sheldon?

(No response.)

The CHAIRMAN. Mr. Royal C. Stephens.

STATEMENT OF ROYAL C. STEPHENS, PHILADELPHIA, PA.

Mr. STEPHENS. Mr. Chairman, I will read my statement and if there are any questions you want to ask, I will be glad to answer them if I can.

Senator GORE. What phase are you going to suggest?

Mr. STEPHENS. I am going to suggest some sources of revenue that have not been mentioned heretofore in Congress that I think will be interesting to the country.

I desire to submit to your committee several suggestions of possible sources of tax revenue that I feel sure has not been considered heretofore by Congress and at the same time I am sure these proposed taxes will meet the approval of the majority of the voters throughout the Nation.

Aliens holding down jobs in place of Americans should be taxed in the following way:

1. An employed alien, in America illegally, tax their employer five times the amount of wages paid said aliens.

2. An employed alien in America 1 year without taking out first citizenship papers, tax them 50 percent of their wages; 2 years, 60 percent of their wages.

Senator GORE. Would you compel them to become citizens if they do not want to?

Mr. STEPHENS. No, and I object to forcing aliens to take out citizenship papers in order to get on relief, as is done in New York, as well.

Senator GORE. If an alien does not think enough of our institutions to take out citizenship papers, you would not want to tax him to compel him to?

Mr. STEPHENS. We want to make way for the Americans.

Mr. GORE. He might condescend to take the other course and become a citizen of the United States to escape the tax.

Mr. STEPHENS. Let me finish my paper first, Senator, and then I will answer your questions.

2. An employed alien in America 1 year without taking our first citizenship papers tax them 50 percent of their wages; 2 years, 60 percent of their wages; 3 years, 70 percent of their wages; 4 years, 80 percent of their wages; 5 years 90 percent of their wages, and in each case of the above scale, tax employer the same amount of wages the alien is taxed.

An employed alien in America who, after taking out first citizenship papers, lets 5 years go by without becoming naturalized, tax him 75 percent of his wages and also tax the employer 75 percent of the wages paid said alien.

Tax married women, whose husbands are gainfully employed to the extent of \$1,200 per year, 50 percent of their wages; also tax the employer of the married women 50 percent of the wages paid to the married women.

May I suggest that the committees in Congress that are charged with raising and appropriating money to run the Government should appoint a clerk to receive and report to the committee all suggestions the clerk finds to be practicable that he may receive from any Federal employees or any citizen on where they can save time, labor, or money in running the Government.

I trust these suggestions are received in the same spirit they are given.

May I say this: My motive in moving to tax the alien is to make the alien who only takes out his first papers and intends to go back, that he will automatically leave the country when he finds it is not profitable for him to be here.

Senator GORE. Instead of taking out his second papers?

Mr. STEPHENS. Exactly.

Senator GORE. He might do that.

Mr. STEPHENS. Well, he might. But let me give you an illustration——

The CHAIRMAN (interposing). We have just received a message to finish up because we are going to finish in a moment and we have one more witness.

Mr. STEPHENS. That is practically all I want to say.

In the mining regions of Pennsylvania, a young fellow whose parents were born abroad said that probably practically 50 percent of those employed are either those with first papers or no papers at all. This sort of taxation thought in my mind was to get at that very thing, and knowing that an alien arrives today, tomorrow he frequently is put to work by our very Americans. It is my object to meet that very same thing, sir, and I should like to say this——

The CHAIRMAN (interposing). The committee is going to adjourn now in a very few minutes. You have your matter in brief form, have you not?

Mr. STEPHENS. Yes.

The CHAIRMAN. Can you not just give that to the committee? Have you about finished with your statement?

Mr. STEPHENS. Yes. I would like to make one more suggestion that is not in there, if I may.

I would like to see a committee appointed by the United States Senate to investigate the expenditure of welfare money relief and so

on, and I would like them particularly to come into Philadelphia and I would show them plenty.

The CHAIRMAN. We will take care of that.

Mr. STEPHENS. Federal money is being wasted.

(The following statement was subsequently submitted by Mr. Stephens:)

PHILADELPHIA, PA., August 7, 1935.

Senator PAT HARRISON,

*Chairman Committee on Finance,
Senate Office Building, Washington, D. C.*

HONORABLE SIR: Since making my remarks on the proposed new tax bill before your committee on last Friday, I afterward felt I should have made myself more clear in answer to Senator Gore's questions and likewise submitted a few more suggestions that should receive full consideration from your committee when attempting to raise more taxes.

Before you consider putting into law my suggestions on taxing the aliens out of the United States—

1. I urge that you pass such legislation as in your opinion may be needed to prohibit any Federal official in any State from granting first citizenship papers to any alien that has been in the United States 1 year prior to January 1, 1934, without applying for their first citizenship papers. Such an act would stop the un-American official action of the welfare official of New York City in giving notice to all aliens on welfare relief that they would have to take out first citizenship papers by January 1, if they wanted to remain on welfare relief.

2. Also legislation to prohibit any Federal official in any State from granting naturalization papers to any alien who has let 5 years go by after taking out first citizenship papers without applying for their final citizenship papers.

Bearing in mind that there are claimed to be between 7 and 9 million unnaturalized aliens in America who are drawing a bonus in lieu of jobs belonging to American citizens, or are drawing a dole by being on welfare relief thus adding to the increased cost to the taxpayers who in turn condemn the Members of Congress and the legislative bodies of every State, county, and city or town for raising their taxes.

Let this sink in: Mr. Harry Hopkins, Welfare Administration, has admitted to Congressman Martin Dies of Texas some time ago, that there are over 600,000 unnaturalized aliens on welfare relief, and you can bet he is away under the number of aliens on relief. But also let this sink in: Mr. Hopkins has also been dictating to the legislators of several States as to how much money they must raise in taxes upon American citizens for welfare relief of the unemployed in their States, and the Members of Congress know only too well how Mr. Hopkins has told them "I need so many million of dollars for welfare relief, raise it for me," without informing Congress that a large part of this money is for relief of aliens in America. No invading army could levy taxes upon the American people in a better way than Mr. Hopkins has forced Congress and the legislative bodies of many States to do in order to raise the money for Mr. Hopkins to keep the citizens of other countries on welfare relief. Mr. Hopkins should be drawing a salary from the countries from which the alien on welfare relief come from.

May I suggest that you request Mr. Harry Hopkins, Welfare Administrator, to furnish you without delay the following information.

1. Number of aliens illegally in America on relief. Also the amount of money spent on them.

2. Number of aliens with no first citizenship papers on relief; also the amount of money spent on them.

3. Number of aliens with first citizenship papers on relief, also the amount of money spent on them.

4. Number of aliens with first citizenship papers on relief who let 5 years go by without becoming a naturalized citizen, also the amount of money spent on them.

Also give the number of the following groups that are on the Public Works relief list waiting to be put to work: 1. Number of aliens in America illegally. 2. Number of aliens with no first citizenship papers. 3. Number of aliens with first citizenship papers. 4. Number of aliens with first citizenship papers who let 5 years go by without taking out their final citizenship papers.

Also request Mr. Hopkins to inform Congress how many destitute aliens could be deported to their own countries. Also request Mr. Hopkins to furnish you such information he can on the following.

1. How many married women whose husbands are gainfully employed are working in his welfare relief organization.

2. What consideration he has given if any toward reducing the number of unemployed on welfare relief by prohibiting the employment of all married women whose husbands are gainfully employed.

May I suggest you consider taxing those American citizens who legally have the right to qualify to vote but do not, unless sickness or absence from home prevent their voting in the following way: First year without voting, \$5; second year without voting, \$10; third year without voting, \$15; fourth year without voting, \$20; fifth year without voting, \$25. At the end of 5 years without voting take their citizenship away from them for 10 years. All aliens doing business in America, tax them five times the amount the American citizen has to pay to do business.

If I could get these suggestions published I am sure the Members of Congress would be swamped with telegrams and letters urging the adoption of these suggestions, which I believe nearly every Member of Congress at heart would like to see carried out.

Trusting these additional suggestions will be considered by your committee, I remain,

Truly,

ROYAL C. STEPHENS.

The CHAIRMAN. Mr. Julian D. Conover.

STATEMENT OF JULIAN D. CONOVER, WASHINGTON, D. C., REPRESENTING THE AMERICAN MINING CONGRESS

Mr. CONOVER. The American Mining Congress represents the various branches of the mining industry of this country. We wish to make a brief statement with regard to the following three matters in connection with the pending tax bill:

1. The graduated corporation income tax.
2. Denial of the right to revalue under the excess profits tax.
3. Elimination of taxes in connection with the liquidation of subsidiary corporations.

(1) We are opposed to the principle of a graduated corporation income tax. We submit that such a tax, in which the rate is based merely on the *size* of the corporate income without reference to invested capital or the size of individual stockholders' interests, is unsound and unfair. We have presented arguments in some detail before the Ways and Means Committee, stating our objections to such a tax on the following grounds:

1. It is inequitable.
2. It constitutes an overburden to enterprise.
3. It will retard recovery.
4. It will tend to discourage development of mineral resources.

Without burdening your honorable committee with a repetition of these arguments, we wish to register our belief that merely narrowing the range of the proposed graduation does not alter the principle involved, and that this principle should not be incorporated in our tax structure.

(2) The bill before your committee calls for a complete revision of the present excess-profits tax, including both a raising of the rates and a lowering of the exemption, but denies the right of the corporate taxpayer to make a revaluation of its capital stock. We submit that this is unjust.

In the Revenue Act of 1934 the excess-profits tax, originally enacted as a part of the National Industrial Recovery Act, was extended for an indefinite period and provision was specifically made whereby

corporations could make a new declaration of value of their capital stock, upon which both the capital stock tax and excess-profits tax would be computed.

Under this act, declarations of value by mining and smelting companies were of necessity made at a time of pronounced business unsettlement. In most cases companies engaged in the mining and dependent industries had an entirely inadequate basis for determining a suitable value.

The CHAIRMAN. You think that the change in capital value now of many of these mining companies, due to the increased prices of certain of their products, would work an inequity?

Mr. CONOVER. We do, unless they are given the right to make a new declaration of the value.

The CHAIRMAN. If you are going to apply an excess-profits tax?

Mr. CONOVER. That is correct, Senator.

When the previous valuations were made, prices of various mineral commodities were at or near the lowest levels in history; earnings had been extremely small or entirely lacking for some years, and the prospects of future earnings were, and to a large extent still are, very dubious. Future prices and costs of production, the two principal factors in determining possible profits, were extremely uncertain. Under the circumstances, values were necessarily declared not on the basis of assured earning power but largely as a matter of guesswork.

The CHAIRMAN. They would raise no objection to an increased tax on the capital stock issue or transfer if they could get the new valuation?

Mr. CONOVER. You mean on transfers of capital stock?

The CHAIRMAN. Yes.

Mr. CONOVER. I do not understand that the question of stock transfers is involved.

The CHAIRMAN. On every issue of capital stock there is a tax imposed?

Mr. CONOVER. Yes.

The CHAIRMAN. It is very small. Then, in order to prevent these corporations from undervaluing their capital stock, they put the 5 percent, or just whatever the figure is, on the excess over 12½ percent. They are permitted to do that, and on any additional earnings over 12½ percent, there is 5 percent, I believe it is, that is imposed.

Mr. CONOVER. That is in the present law?

The CHAIRMAN. Yes.

Mr. CONOVER. Yes, sir.

The CHAIRMAN. We did that in order to give these people the right to voluntarily set up their own capital stock and say what the value of it was. Now if we should permit new declarations of capital stock, you would not object to an increase in the capital stock issue?

Mr. CONOVER. No, the companies would be, if I understand you correctly, the corporations would be entirely willing to pay the present rate of capital-stock tax on their new declared value.

In connection with these previous valuations, the amount of tax which would be required under the capital-stock tax, on the one hand, and the excess-profits tax on the other were of course given consideration, and in the absence of many of the usual yardsticks for establishing fair value, the anticipated taxes under these two heads were necessarily an important factor in arriving at the declared value. If the

value thus declared should prove to be too high, the corporation would be penalized by an excessive capital-stock tax. If the declared value should prove to be too low, the corporation would be penalized, at such time as earnings increased, by too great an excess-profits tax. These contingencies were apparent and were of course taken into account in the declaration of capital-stock value, on the basis of the capital stock and the excess-profits tax rates then established. It was not anticipated that the rates of tax, and particularly the basic rate of earnings not subject to excess-profits tax, would be arbitrarily changed without affording taxpayers the right of revaluation.

The bill now before your committee proposes a drastic change both in the base and the rates of the excess-profits tax. Instead of a rate of 5 percent on earnings in excess of $12\frac{1}{2}$ percent of the adjusted declared value, it would provide rates of 5 percent to 20 percent on earnings in excess of only 8 percent of the adjusted declared value. This would make a vast difference in the tax liability of great numbers of corporations, particularly where the value previously declared has proved to be too low; in other words, where improved markets or other changed conditions make the value today greater than was declared at that time.

We respectfully submit that if a change in the excess profits tax is now considered necessary, it should, as a matter of justice to taxpayers be accompanied by the right to redeclare the value of the capital stock in the same manner as accorded in the 1934 act.

As to the application of the proposed rates of tax, we wish to point out that the proposed base of 8 percent, with excess profits taxes on all earnings in excess of that percent, would bear with special severity upon the mining and smelting industry. These enterprises generally are subject to more violent fluctuations in earnings than many other types of industrial activities. The market price and volume of business varies widely from year to year. Usually a number of years of small earnings or losses are followed by short periods in which earnings are relatively large. In the latter periods an income of far more than 8 percent is needed to make up for the losses of the previous years. Investment in mining properties would greatly diminish if profits substantially in excess of 8 percent could not be realized in good times. To impose excessive taxes not only would cut down the chance of recovering losses previously sustained, but would discourage investment in this industry.

If it is the feeling of Congress that a more drastic excess-profits tax is needed, we suggest that careful consideration be given to industries such as the mining and smelting industry which are marked by violent fluctuations in income, and that the law be written so as to levy the taxes more nearly on average income over a period of years than solely on the income of fortunate years. Prior to 1933 taxpayers were permitted to carry forward losses as a deduction against the profits of the following years, and we respectfully suggest that in case your committee sees fit to adopt an excess-profits tax schedule such as now proposed, a similar provision for the carrying forward of the previous years' losses be made, at least insofar as such excess-profits tax is concerned.

(3) The third subject on which we wish to comment is the proposed addition to the bill now before you of a provision to eliminate all

taxes in connection with the liquidation of subsidiary companies. We understand from the public press that your chairman has directed Mr. L. H. Parker, Chief of Staff of the Joint Committee on Internal Revenue Taxation, to draft such a provision for the consideration of the committee.

The CHAIRMAN. I would suggest to you on that, that we have instructed our experts to give special study to the proposition.

Mr. CONOVER. I am very glad to hear that, Senator.

The CHAIRMAN. If you will just put your views in the record on that proposition, it will be given consideration.

Mr. CONOVER. We have stated them here, and will be glad to include them in the record.

Under the present law the Treasury Department has taken the position that elimination of a wholly owned subsidiary by a parent corporation does not constitute a nontaxable reorganization under section 112 of the Revenue Act of 1934, but that it constitutes a distribution in liquidation under section 115 (c) of that act, and that such distribution results in gain or loss depending upon whether the amount of such distribution is greater or less than the cost to the parent of its stock in the subsidiary. This question has not yet been settled by the courts and there is no early prospect that it will be. This results in a most unfortunate uncertainty as to transactions of this type.

In many cases, mining and other corporations find it desirable to simplify their corporate structures through elimination of those subsidiary companies which are found to be unnecessary. However, such action, which incidentally is in harmony with the administration's expressed desire for simplification of corporate structures, is largely thwarted by the Treasury's view that elimination of such subsidiary corporations results in taxable gain or deductible loss to the parent corporation.

We submit that when a subsidiary is dissolved and its assets transferred to the parent corporation there should be no tax upon such transaction. A parent and its wholly owned subsidiary represent nothing more than a single business enterprise, owned by a single group of stockholders, in form operating under two separate entities. Under section 112, the merging of two separate businesses owned by two separate and distinct groups of stockholders is treated as a nontaxable reorganization, and we submit that there is even more reason for according similar treatment to the consolidation of the various corporate branches of a single business enterprise.

We therefore endorse the proposal which we understand has been made by your chairman, and respectfully urge the adoption of such a provision.

In summary, the American Mining Congress urges the views of the mining industries of this country as follows:

(1) The graduated corporation income tax is wrong in principle and should not be adopted in any form.

(2) In case a revision of the present excess-profits tax is desired by Congress, this should be accompanied by the right to redeclare the value of capital stock in the same manner as in the 1934 act. Industries such as the mining and smelting industry, which are subject to extreme fluctuations in earnings, should be permitted to carry

forward previous years' losses as a deduction against current income, at least insofar as excess-profits tax is concerned.

(3) The ambiguity in the present law relating to tax upon the liquidation of subsidiary corporations should be removed by a definite provision that such transactions are not subject to tax.

The CHAIRMAN. Thank you very much. The committee recesses until 10 o'clock Monday morning, August 5, 1935.

(Whereupon, at 12:25 o'clock p. m., the committee recessed to Monday, Aug. 5, 1935, at 10 a. m.)

REVENUE ACT OF 1935

TUESDAY, AUGUST 6, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in the Finance Committee room, Senate Office Building, Senator Robert M. La Follette, Jr., presiding.

Present: Senators La Follette (presiding), King, Walsh, Barkley, Costigan, Gerry, Guffey, and Capper.

Senator LA FOLLETTE. The committee will be in order. Mr. Jackson.

STATEMENT OF ROBERT H. JACKSON, ASSISTANT GENERAL COUNSEL, TREASURY DEPARTMENT

Mr. JACKSON. The staff of the Treasury Department has made two separate studies which I have summarized separately, and if it meets with your approval, I will take up first the subject of the individual income, inheritance and gift taxes, and then go into the corporation tax after we have completed those.

Senator LA FOLLETTE. The committee will be glad to have you proceed in your own way, Mr. Jackson.

Mr. JACKSON. Last July 8 Secretary Morgenthau said to the Ways and Means Committee [reading]:

The Treasury's first concern is with the adequacy of the national revenue.

He also pointed out that, since the impact of taxes must be felt beyond the affairs of the immediate taxpayer, the Treasury is also concerned with the secondary effects of existing tax laws and with probable secondary effects of any proposed laws.

The purpose of this statement is to summarize Treasury information and experience in tax administration, and data as to underlying economic conditions, which may be found helpful in considering the recommendations of the President's tax message of June 19, 1935.

I will first deal with the proposal to extend the application of the principle of taxing according to the individual's ability to pay, to income, inheritance and gift taxes, leaving the conditions affecting corporate enterprises for later and separate treatment.

HOW IS THE PRESENT TAX BURDEN CARRIED?

As the figures of tax collections have become available, it has become apparent that the present administration inherited in 1933 a tax structure which, in terms of making that burden proportional to ability to pay, had become out of balance even by the standards adopted during the preceding administration.

Income, gift, estate, capital stock and excess profits taxes, which are the taxes that bear most heavily on accumulated wealth, do not constitute the entire Federal tax burden.

Miscellaneous internal revenue taxes and our entire structure of customs taxes and now processing taxes have an incidence that has little relation to ability to contribute to the cost of government. It is a commonplace that such taxes are proportional to consumption, hit poorer classes hardest, and rest with greater weight upon large families with small incomes than they do upon small families with large incomes.

It may be assumed that collections in the year 1930, governed largely by the Revenue Act of 1928, represented a ratio of burden between these two types of taxes, fairly deliberately arrived at, without intent to unduly penalize the more affluent. In that year we find that those taxes bearing most heavily on the well-to-do contributed \$2,475,000,000 to the National Treasury, or 68.2 percent of its total internal revenue and customs receipts, while miscellaneous taxes and customs receipts, bearing most heavily upon the consumer, contributed only \$1,152,000,000, or 31.8 percent of such receipts. By 1933, however, this ratio had so changed that only \$781,000,000 was raised from the taxes based on ability to pay and that sum constituted only 41.7 percent of the Federal internal revenue and customs receipts, while taxes based on consumption produced \$1,090,000,000, or 58.3 percent of such Federal receipts.

Since 1933 the trend has been in the same direction but the percentage change relatively small. In 1935 the taxes based on ability to pay contributed 38.7 percent of the internal revenue and customs receipts, or a decline since 1933 of only about 3 percent; and, during the same period, there has been an increase in the proportion of revenues contributed by taxes based on consumption from 58.3 to 61.3, an increase of only about 3 percent. Supporting data are shown in the following table.

We have set forth the table which shows the annual breakdown of this steady drift toward a heavier burden upon the consumer and a lighter burden upon those classes which we rate as being able to pay.

Senator LA FOLLETTE. The table may be inserted in your testimony.

*Federal tax collections*¹—Gasoline, electrical energy, soft drinks, candy, matches, tires and tubes, radio, jewelry, etc.

[Millions of dollars]

	Amount, 1930	Percent	Amount, 1931	Percent	Amount, 1932	Percent
Income taxes.....	2,410	66.4	1,860	66.3	1,057	56.0
Estate and gift tax.....	65	1.8	48	1.7	47	2.5
Total.....	2,475	68.2	1,908	68.0	1,104	58.5
Miscellaneous internal revenue.....	565	15.6	520	18.5	454	24.1
Customs.....	587	16.2	378	13.5	328	17.4
Total.....	1,152 3,627	31.8 100.0	898 2,806	32.0 100.0	782 1,886	41.5 100.0

¹ Figures for Customs from Daily Treasury Statement; all others from Bureau of Internal Revenue.

Federal tax collections—Gasoline, electrical energy, soft drinks, candy, matches, tires and tubes, radio, jewelry, etc.—Continued

	Amount, 1933	Percent	Amount, 1934	Percent	Amount, 1935	Percent
Income taxes.....	747	39.9	817	27.4	1,099	30.2
Estate and gift tax.....	34	1.8	113	3.8	212	5.8
Capital stock and excess-profit taxes.....			83	2.7	98	2.7
Total.....	781	41.7	1,013	33.9	1,409	38.7
Miscellaneous internal revenue.....	839	44.9	1,288	43.2	1,364	37.5
Customs.....	251	13.4	313	10.5	343	9.4
Processing taxes.....			371	12.4	526	14.4
Total.....	1,090 1,871	58.3 100.0	1,972 2,985	66.1 100.0	2,233 3,642	61.3 100.0

Mr. JACKSON. Reference to the Revenue Act of 1932 will show the manufacturers' excises which were added and the various tax changes which were made in that year which contributed of course to a changed ratio.

While the shift in the tax burden from those more able to those less able to pay has been small from 1933 to 1935, this shift, however small, is unsound. The trend should be reversed.

In weighing this shifting burden of taxation, allowance must also be made for declining incomes which make the relative weight of these consumer taxes greater than mere yield would signify. These taxes are paid largely out of consumers' purchasing power, and are borne to a great extent by those whose incomes are barely adequate for maintenance and who lack other resources to fall back upon. The burden of taxation should be so readjusted as to meet the cost of government by a recovery tax program that will eliminate the present inequities and that will not impair the purchasing power of the mass of consumers.

The cost of the emergency measures to combat the depression has of necessity been met largely by borrowing. As we emerge from the depression, it is time to make such adjustments in the tax structure as will meet the postponed costs of protecting the social order with a tax structure in which the balance between taxes levied on the basis of ability to pay and taxes based on consumption is more equitable.

Added revenue to go toward balancing the Budget and toward meeting the cost of overcoming a depression which threatened rights of property, should be contributed by the propertied class in proportion to their ability to pay.

AS TO CONCENTRATION OF INDIVIDUAL WEALTH IN THE UNITED STATES

It is well known that the per capita income of the United States, particularly in the years 1928 and 1929 ranked among the highest in the world, and resulted in a high standard of living.

When the total income of the United States is averaged, the figures are impressive, but when it is viewed, not as it might be, if it were equalized by averaging, but as it actually is distributed, the result must arouse concern.

Even informed observers were startled at the tendency to concentration, and the rate of concentration indicated by the 1933 returns. The number of persons filing income tax returns decreased from 1932 by 3.8 percent. Not all who file returns pay taxes, because of exemptions, so that only 1,747,740 persons out of our entire population reported taxable incomes and the total amount of income reported fell by 5.5 percent. Yet in the face of generally declining incomes, and in spite of the bank holiday and other events of that year, the number who reported net taxable incomes of \$1,000,000 or over more than doubled, having increased from 20 in 1932 to 50 such persons in 1933.

By general consent, our income tax laws, under all administrations, having provided exemptions, in amounts considered necessary to reasonable subsistence, so as to avoid depressing the standard of living within the lower income groups. The significant result is that when the groups that are considered to need all of their income for necessities are left out, we have only a relatively small number left. Applying the standard thus set by Congress as necessary to a reasonable way of life, we find the largest number who ever rose above that standard, as evidenced by the number of returns indicating taxable incomes, to be 5,518,310. This was in 1920 when exemptions allowed were at their lowest. In 1933 the returns filed which showed taxable incomes numbered 1,747,740.

The conclusion indicated by Treasury statistics is that the base for our income tax is now seriously narrow, and results in part from the fact that the number of people having incomes above a generally accepted subsistence level is seriously small.

Treasury statistics, on individual incomes, point to the same conclusions as a recent study of incomes by family groups. This basis is also important because the family is the usual unit of spending.

Recently the Brookings Institution, in connection with its study, "America's Capacity to Consume", presented figures on the distribution of our national income in the year 1929 by family units.

The following estimates were disclosed:

Nearly 6,000,000 families, or more than 21 percent of the total, had incomes less than \$1,000 annually or less than \$25 a week.

About 12,000,000 families, or more than 42 percent, had incomes less than \$1,500.

Nearly 20,000,000 families, or 71 percent, had incomes less than \$2,500.

Only a little over 2,000,000 families, or 8 percent, had incomes in excess of \$5,000.

About 600,000 families, or 2.3 percent, had incomes in excess of \$10,000.

In the year 1929, 36,000 high income families received as much of our national income as 11,000,000 families with the lowest incomes.

We have just studied the incomes of 58 taxpayers who, in 1932, reported total taxable and nontaxable incomes exceeding \$1,000,000. Of the 58 such taxpayers, 38, or over 70 percent, are accounted for by membership in 14 families. This indicates that statistics may fail to reveal the true extent of concentration of opportunity and control, and hence of the benefit of organized government and of both ability and duty to pay taxes.

Large incomes are derived in the main from invested capital not from wages or salaries. The concentration of income among a small number of individuals results from, and at the same time furthers, wealth concentration. Unfortunately, information relating to the distribution of wealth is less definite than that relating to distribution of income, but the estate tax returns filed in 1932, while not fully indicative, do give us some idea of the measure of wealth concentration. They are shown in the following table—I won't read the table—but I will ask to have it inserted.

Senator KING (presiding). It may be inserted.

Net estate classes ¹	Number of returns	Per-cent	Value of gross estate ²	Per-cent
Nontaxable.....	2, 009	28. 3	\$184, 000	7. 7
Under \$100,000.....	2, 762	28. 8	442, 000	18. 4
\$100,000-\$400,000.....	1, 600	22. 5	564, 000	23. 5
\$400,000-\$1,000,000.....	500	7. 0	429, 000	17. 8
\$1,000,000-\$5,000,000.....	215	3. 0	507, 000	21. 0
\$5,000,000-\$10,000,000.....	21	. 3	168, 000	7. 0
\$10,000,000 and over.....	6	. 1	110, 000	4. 6
Total.....	7, 113	100. 0	2, 404, 000	100. 0

¹ After allowable deductions and a specific exemption of \$100,000 for each estate.

² Gross estate value as reported less indebtedness against the estates.

Mr. JACKSON. This table shows that nearly one-third of all the property reported as passing by death was concentrated in less than 4 percent of the estates, none of which were valued at less than 1 million net, and if we drop down a little and begin with net estates of \$400,000 we find that one-half of the property included in estate-tax returns in the United States in 1932 was included in 10 percent of the estates. Rough as this measure is admitted to be, it none the less presents stubborn evidence that wealth is concentrated in a few hands.

DO LARGE AGGREGATIONS TEND TO DISTRIBUTE THEMSELVES?

It is often asserted that large wealth is dissipated in three generations, and it has become a proverb that it is "three generations from shirt sleeves to shirt sleeves." It was doubtless once true that all a grandfather saved from the fruits of his labor could be spent by a grandson. It is probably true today of very moderate fortunes. It is not true of large invested fortunes under present conditions. They not only perpetuate themselves, they grow.

This is because they are now so large. A riotous living heir to one of our larger fortunes would exhaust himself before he could exhaust the income alone of the estate. Furthermore, such estates are largely perpetuated in trusts, and every legal and economic obstacle to their dissipation is employed. They are invested in the enterprises of the country where the income and management are not dependent upon the judgment or industry of the heir, or are invested in tax-free Government securities.

Most of the large estates as at present managed, we find, not only perpetuate themselves but are larger as they pass from generation to generation. With large incomes from inherited property remaining intact or actually increasing, there results a diversion of a large pro-

portion of the community's productive resources to the satisfaction of the wants of a few individuals, and a fastening of control in few hands.

As pointed out earlier, under the prevailing distribution of income, even in the most prosperous times, a large proportion of the population lives at or even below the level recognized by Congress as necessary for adequate subsistence. In a period of depression this same proportion of the population is pressed further down the scale of living while those in higher income groups, even though they suffer some reduction of income, are in a position to use their vast resources to maintain their accustomed very high standards of living. In devising taxes on the basis of ability to pay, those groups should have their tax burden readjusted to help meet the costs of protecting the social order in proportion to the advantages which they enjoy.

I am aware that some statistics have been published recently, referred to in the hearings of this committee and quoted by such papers as the New York Times, which would seem to contradict the statistics which I have given you.

The article I refer to is by Mr. Doane in *The Annalist*, and I want to call your attention since it has been brought to your notice, to the basis upon which those figures are compiled, and in which Mr. Doane reaches the conclusion that wealth really is very broadly dispersed in the United States.

He takes the number of security holders as one of his tests and estimates that there are 24,000,000 security owners in the United States. Other estimates which have been made to you here were as high as 9,000,000.

It is perfectly obvious that if there are 24,000,000 security holders in the United States and only 1,700,000 reported taxable incomes, that the people who have no taxable incomes are the great owners of our industry, and that conclusion cannot be reached.

Mr. Doane's figures are based upon the number of record holders of securities and ignores the enormous number of duplications.

The most decisive proof of the extreme concentration of corporate stock ownership in the United States, in contrast to the great diffusion claimed by Mr. Doane, is to be found in the Statistics of Income for 1929—that banner year of public interest in corporate securities. In that year, more than 83 percent of all dividends paid to individuals by corporations were received by the 3.28 percent of the population who filed income-tax returns. In that year, moreover, the personal exemption for a married man was \$3,500, and for a single man \$1,500, as contrasted with the present exemptions of \$2,500 and \$1,000, respectively. Further, the dividends paid to those who did not file income-tax returns—constituting only 16.95 percent of the aggregate dividends paid to individuals—included the amounts paid to universities, foundations, eleemosynary institutions, and the like, many of which own large amounts of corporate stocks. It is also striking to note that 78.17 percent of all the dividends reported by individuals filing income-tax returns for 1929 was reported by individuals with taxable net incomes of \$10,000 or more—who constituted only 0.357 percent of our population—a little over one-third of 1 percent of our population.

Mr. Doane also cites the distribution of insurance policies as evidence of wide distribution of wealth. He claims that there were 63,350,000 individual owners of life-insurance policies in the United

States in 1932. I will call your attention to the fact that he includes industrial insurance, and that industrial insurance accounts for 74 percent of the outstanding policies.

Mr. Ecker, the president of the Metropolitan Life Insurance Co., testified before the New York Commission on Old Age Security in 1929 that 15.8 percent of all newly written industrial policies lapse in the first week, 7 percent in the second week, and 85 percent in the first year. So that any statistics on the distribution of wealth which includes policies of people who are only able to hold them for a year is completely illusory and do not in our view in any respect contradict the statistics that I give you from income tax sources.

Senator LA FOLLETTE. Mr. Jackson, if you have any further additional analysis of that article in the *Annalist*, I should like to have it included in the record at the proper place.

Mr. JACKSON. I would be very glad to include it. We have analyzed it somewhat further. I thought perhaps it would hardly pay to go into it in too much detail, but I will be glad to include the analysis.

(The same is as follows:)

ANALYSIS OF THE ARTICLE OF ROBERT RUTHERFORD DOANE

TREASURY DEPARTMENT, *August 2, 1935.*

Subject: The article of Mr. Robert Rutherford Doane, Summary of the Evidence of the National Wealth and Its Increasing Diffusion, appearing in the *Annalist* for July 26, 1935.

Mr. Doane's article purports to submit figures proving an extremely wide diffusion of wealth in the United States. These figures are mainly contained in his table 4. They are very misleading. Some of their weaknesses are pointed out below.

Security holders.—Mr. Doane estimates that there are 24,000,000 security owners in the United States. This figure is extremely misleading. Mr. Doane's estimate was apparently based upon the number of bookholders of securities, and apparently ignores the enormous number of duplications. A wealthy man who owns stocks in 100 different corporations would be counted as 100 stockholders in this kind of compilation. The most decisive proof of the extreme concentration of corporate stock ownership in the United States, in contrast to the great diffusion claimed by Mr. Doane, is to be found in the Statistics of Income for 1929—that banner year of public interest in corporate securities. In that year, more than 83 percent of all dividends paid to individuals by corporations were received by the 3.28 percent of the population who filed income-tax returns. In that year moreover, the personal exemption for a married man was \$3,500, and for a single man \$1,500, as contrasted with the present exemptions of \$2,500 and \$1,000, respectively. Further, the dividends paid to those who did not file income tax returns—constituting only 16.95 percent of the aggregate dividends paid to individuals—included the amounts paid to universities, foundations, eleemosynary institutions, and the like, many of which own large amounts of corporate stocks. It is also striking to note that 78.17 percent of all the dividends reported by individuals filing income-tax returns for 1929 was reported by individuals with taxable net incomes of \$10,000 or more—who constituted only 0.357 percent of our population; three hundred and fifty-seven thousandths of 1 percent or little over one-third of 1 percent.

Life insurance.—According to Mr. Doane, there were 63,350,000 individual owners of life-insurance policies in the United States in 1932. This figure is arrived at, he states, by taking two-thirds of all ordinary life-insurance policies outstanding and one-half of all industrial policies in order to allow for duplication.

Out of 100,333,822 policies in force on December 31, 1931, according to the Annual Report of the New York Superintendent of Life Insurance, 74,526,630, or 74.3 percent, were "industrial" policies, and 25,807,192, or 25.7 percent, were "ordinary" policies. Applying these same percentages to Mr. Doane's adjusted figures, over 47,000,000 of the individual policyholders hold industrial life insurance and only about 16,000,000 hold ordinary life insurance. Industrial life

insurance is written in amounts of usually \$500 or less, collected by agents through weekly premiums. The aggregate face amount of such insurance is consequently only a very small fraction of the aggregate face amount of all life-insurance policies. This is only a small portion of the story, however, since whereas ordinary life-insurance policies oftentimes remain in force many years and acquire cash surrender values representing a very substantial fraction of their face amount, this is very seldom the case with industrial insurance, which turns over very rapidly. According to the testimony of Mr. Frederick H. Ecker, president of the Metropolitan Life Insurance Co., by all odds the most important company in the industrial insurance field, given before the New York Commission on Old-Age Security in 1929, 15.8 percent of all newly written industrial policies lapse in the first week. The aggregate cash value belonging to the 47,000,000 presumptive industrial policyholders can therefore be little more than nominal, and we ought to confine ourselves to the amount belonging to the 16,000,000 presumptive ordinary policyholders.

Even concentrating our attention on the ordinary policyholders, however, we may readily be deceived by the force of large numbers of policy-owning but a small portion of total life-insurance reserves. Mr. Doane has adjusted his figure for policies to policyholders by assuming that there are two-thirds as many of the latter as of the former. The significance of his table for the distribution of wealth would be vastly different if he took account of the fact that while the policyholders at the bottom of the heap hold but one policy, those at the top hold a great many. Mr. Doane's method, of course, greatly exaggerates the importance of the small policyholders. Actually, a very large proportion of ordinary policies are written for only \$1,000. There is every reason to believe that the great bulk of the cash-surrender value of all outstanding life-insurance policies is held by 1 or 2 million policyholders.

Savings deposits.—Mr. Doane's second largest figure for individual owners is \$44,352,106 for savings depositors. Here again the figure is bigger than its significance. On October 1, 1934, 56.5 percent of all deposits held by banks insured by the Federal Deposit Insurance Corporation were uninsured and represented the amount in excess of \$5,000 of individual deposits of more than this amount, except for about half of the mutual savings banks, where the maximum insurable amount was only \$2,500. This 56.5 percent of the deposits was held by only 1.5 percent of the depositors. These figures clearly indicate, as far as all banks are concerned, that the large number of accounts is without much significance, since the values are concentrated in relatively few hands.

Such figures as are available for the mutual savings banks alone show a similar concentration, although not quite so exaggerated a one. The 1931 report of the Connecticut bank commissioner shows that 80.4 percent of all accounts in mutual savings banks in Connecticut were for amounts of less than \$1,000 each, but the total of such accounts represented only 18.5 percent of the deposit liability of the banks.

Automobile ownership.—Mr. Doane cites 20,886,000 automobile owners in 1932. It is true that an automobile often constitutes the major portion of the poor man's wealth. Even here, however, it is to be noted that the older cars are of very little monetary value and most new cars are purchased on time.

Home ownership and building and loan association shares.—Mr. Doane's remaining figures are 13,283,434 home owners and 10,102,258 building and loan shareholders. The building and loan shareholder figures are probably of the same order of significance as those for savings depositors, although detailed data are not readily available. The figure for home owners is of much greater significance. It is indeed true that a home, a car, a life-insurance policy, and a bank account are about the only forms of wealth to which poor men even aspire. Mr. Doane's 13,000,000 home owners, however, it must be noted, are in a large part equity owners. How large a proportion of them hold an entirely illusory equity and how many of them a very feeble one remains to be seen.

Senator KING. It is a fact, is it not, that in many of these large corporations such as the Telephone Co., there are 5 or 6 hundred thousand stockholders?

Mr. JACKSON. That is very true, Senator.

Senator KING. And in many other corporations there are a large number of stockholders?

Mr. JACKSON. That is very true. But you will find that a large number of persons who own 2 or 3 or 4 or 6 or 8 shares, make a very

large number of stockholders, but if you compile the figures as to the relative importance to those stockholders of the dividends received, you will find that the persons having small incomes receive perhaps less than 5 percent of their income from dividend sources, while those over a million receive more than half of their income from dividend sources, and the importance of dividends in the lower-income brackets is relatively insignificant. Wages and salaries is the thing that counts up to \$10,000.

Senator KING. Would persons who have two or three or four or five or six shares, the income upon which would be less than 3 or 4 hundred dollars, and the aggregate of their earnings for the year—they would be all exempt—would they make returns?

Mr. JACKSON. Not unless their gross income brought them within the required amount.

Senator KING. So that there might be a large number of persons who would be recipients of dividends in corporations who would make no returns because their aggregate income would be less than the amount of exemption.

Mr. JACKSON. There probably are a large number who receive dividends and make no returns, but we are able to check the amount of dividends returned against the amount paid in the country and we find that more than 83 percent of all dividends were paid by persons who did file returns. So the amount in volume of dividends going to persons who do not pay income tax or do not file income-tax returns is relatively insignificant.

Senator GERRY. Have you got the number of persons who do receive dividends irrespective of amount?

Mr. JACKSON. I have them, Senator. I do not think they are included in this statement because I have them in the corporation-tax return discussion.

Senator GERRY. You have records then of all of the people that receive dividends from corporations?

Mr. JACKSON. Oh, yes; if they file income-tax returns.

Senator GERRY. And if they do not?

Mr. JACKSON. If they do not, we do not have them, but those who do file account for 83 percent of the dividends paid.

Senator GERRY. I understand that. That was not my question.

Mr. JACKSON. We have no statistics from which we can say what dividends are paid in numbers of dividend-receiving population.

Senator GERRY. That is what I wanted to know.

Mr. JACKSON. Outside of those who have filed returns.

Senator KING. And I suppose that a large number of those who file returns, their total income would be less than \$5,000?

Mr. JACKSON. That is true, but for them we have the statistics.

Senator KING. Of those who are less than \$5,000?

Mr. JACKSON. Yes.

Senator KING. How many stockholders are there in the United States who file returns for less than \$5,000 and who show dividends from corporations?

Mr. JACKSON. I do not think I could give you that offhand, Senator, but I will get it for you.

Senator KING. Yes.

Mr. JACKSON. And I will give you in the statement relating to corporation taxes the amounts of dividends paid to those under \$5,000

of income, so that you will have that data, and I will get you the statistics and the number.

Senator KING. Are you presenting what you conceive to be a factual situation rather than an argument in favor of the taxation of capital under the guise of an income or corporation tax?

Mr. JACKSON. I am presenting the facts which we find in the administration of this law, and the conclusions that they indicate, reasonable men may differ about.

Senator KING. You are not attempting to establish the thesis that the Government under the guise of taxation will destroy property holdings?

Mr. JACKSON. I certainly would not attempt to establish that thesis.

Senator KING. Or to break up estates or destroy all investments because they are large, under the guise of taxation?

Mr. JACKSON. That is a little different proposition. I think that the large holdings should bear the tax burden of sustaining the social order in proportion to the benefits they get out of it. I do not think that destroys them.

Senator KING. Under the guise of taxation, you would, as you say, take from them sufficient to be commensurate with the benefits which you allege they have received?

Mr. JACKSON. The benefits which we find they received.

Senator KING. In what?

Mr. JACKSON. In income. If a man takes a million dollars a year under the protection of the laws of the United States, out of the national income, I think that he has had a million dollars benefit for that year out of the operations of the social order.

Senator GERRY. Are you making your argument as to income or inheritance?

Mr. JACKSON. I have presented here facts, Senator Gerry, which I think bear on both propositions advanced by the President.

I will now take up the income-tax situation separately, because it presents a separate problem from inheritance.

Senator GERRY. I thought you were speaking to the inheritance-tax section mainly, from your remarks as I listened to them. Am I correct in that?

Mr. JACKSON. These facts as to concentration are general and apply to both the concentration of wealth and income.

AS TO INCOME TAX

The President, in suggesting an extension of the principle of graduation to large incomes, used as an illustration of the defects of present schedules, the failure to apply the principle to incomes over \$1,000,000. The inconsistency of failing to apply the principle of graduation at all above the \$1,000,000 income is an illustrative, but not the only, inconsistency in the present schedule. Before the million-dollar income is reached our rates on very large incomes rise very slowly. Thus, while the top bracket rate for a man with a \$5,000 income is double the rate for one with a \$4,000 income, and the top bracket rates rise from 4 percent to 54 percent between taxable net incomes of \$4,000 and \$100,000, the top bracket rates thereafter increase very slowly. From just over \$100,000 to anything in excess of \$1,000,000 of annual income, the top bracket rate increases only

from 56 to 63 percent; and thereafter it does not increase at all, being the same for an annual income of one million and one dollars, two million, or five million dollars.

The progression of the effective rate on selected net incomes from \$3,000 to \$2,000,000 is shown in the following table:

Senator LA FOLLETTE. The table may be inserted.

(The table is as follows:)

*Effective rates of tax on selected net incomes*¹

Net income	Rate	Difference between classes	Net income	Rate	Difference between classes
	<i>Percent</i>			<i>Percent</i>	
\$3,000.....	0.3		\$100,000.....	28.7	12.6
\$5,000.....	1.1	0.8	\$500,000.....	50.0	21.3
\$10,000.....	3.4	2.3	\$1,000,000.....	54.6	4.6
\$20,000.....	6.9	3.5	\$2,000,000.....	57.4	3.2
\$50,000.....	16.1	9.2			

¹ Based on 1934 rates, applied to incomes reported in Statistics of Income for 1933. Account has been taken of dividends, partially exempt interest, and earned income credit, all of which are exempt from the normal tax. A deduction of \$2,500 (i. e., the personal exemption for a married person with no dependents) was made from each net income shown above.

Mr. JACKSON. You will note that by the time \$50,000 of net income has been reached the effective rate of tax is 16.1 percent. There is then an increase of 1.6 points, to 28.7 percent, over an interval of the next \$50,000. Over the succeeding interval of \$400,000 there is a further increase of 21.3 points, so that the effective rate on a net income of \$500,000 is 50 percent. Over the next interval of \$500,000 the effective rate increases only 4.6 points, to 54.6 percent; and over the next interval of \$1,000,000 there is an increase of only 3.2 points to an effective tax rate of 57.4 percent. The rate of progression suddenly slows up as the higher incomes are reached.

It must be emphasized, moreover, that our bracket rates are not the rates that are effective for the whole of an income. Each bracket rate applies only to a stated segment of the income; hence, a large part of all incomes are taxed at substantially lower rates than the rate applicable only to the last portion. On a \$50,000 income, for example, the highest bracket rate, plus the normal rate, is 31 percent, but the actual effective rate is only 16.1 percent.

It is obvious that needed additional revenue might be obtained by a more consistent application of the principle of graduating the tax rate according to ability to pay.

The numbers of taxpayers in high-income brackets, advantaged by the sudden slowing up of the rate of progression for the last 5 years for which figures are available, have been as follows:

	Over \$50,000 net income	Over \$100,000 net income	Over \$500,000 net income	Over \$1,000,000 net income
1929.....	38,889	14,816	1,489	513
1930.....	19,487	6,202	468	150
1931.....	11,014	3,184	226	77
1932.....	7,738	1,836	106	20
1933.....	8,072	2,047	130	50

The figures are set forth, as you will note, for \$50,000, \$100,000, \$500,000, and \$1,000,000.

Senator LA FOLLETTE. I think it would be helpful, Mr. Jackson, if you would insert a table which would show the effective rate on each of the brackets, in connection with the statement and table just referred to.

Mr. JACKSON. I can furnish, Senator, a comparison of the present individual tax rates and the rates proposed in the House Ways and Means Committee bill showing the effective rate, the bracket rates, and the effective rates both under the existing and proposed schedules.

Senator LA FOLLETTE. I think that would be very helpful.

Senator GERRY. Is that not already in the majority report?

Mr. JACKSON. I do not know whether it is or not.

Senator GERRY. My recollection is that it is, but there is no reason why it should not be put in here.

Senator LA FOLLETTE. It might be helpful to put it in at this point..

Mr. JACKSON. I will be glad to furnish that table for the record.

(The table is as follows:)

Comparison of present individual income-tax rates and rates proposed in House Ways and Means Committee bill, July 29, 1935

Net income classes (in thousands of dollars)	Existing rate		Proposed rate	
	Bracket rates (normal and surtax)	Effective totality rates ¹	Bracket rates (normal and surtax)	Effective totality rates ¹
	Percent	Percent	Percent	Percent
44 to 50.....	31	19.40	31	19.40
50 to 56.....	34	20.96	35	21.07
56 to 62.....	37	22.52	39	22.81
62 to 68.....	40	24.06	43	24.59
68 to 74.....	43	25.59	47	26.41
74 to 80.....	46	27.13	51	28.25
80 to 90.....	49	29.56	55	31.22
90 to 100.....	54	32.00	59	34.00
100 to 150.....	56	40.00	62	43.33
150 to 200.....	57	44.25	64	48.50
200 to 250.....	58	47.00	66	52.00
250 to 300.....	58	48.83	68	54.67
300 to 400.....	59	51.38	70	58.50
400 to 500.....	60	53.10	72	61.20
500 to 750.....	61	55.73	74	65.47
750 to 1,000.....	62	57.30	76	68.10
1,000 to 2,000.....	63	60.15	77	72.55
2,000 to 5,000.....	63	61.86	78	75.82
Over 5,000.....	63	-----	79	-----

¹ Computed on highest amount in bracket.

LEGAL VERSUS EFFECTIVE INCOME TAX RATES

Mr. JACKSON. The tax burden is not a mere matter of rates written into the law. Actual collections determine the burden carried, and administrative provisions and procedures have resulted in the income-tax law in the higher brackets being considerably less effective in application than income tax in the lower brackets.

The Treasury is deeply concerned over the problems of enforcement some defects of which it calls to your attention, both for whatever consideration you feel it should have in shaping the policy of the law and rates of tax, and also because we find fair and equal enforcement to be itself a problem which the Congress must soon deal with.

Congress lays a surtax rate of 4 percent on an income between 4 and 6 thousand dollars. In actual operation that means that the average tax payer within that range of income really pays to the Federal Government a surtax of 4 percent on that \$2,000. On the other hand, Congress lays a surtax rate of 59 percent on net incomes in excess of \$1,000,000, but that does not, by any means, indicate that each taxpayer in that range of income pays a surtax of 59 percent on all such excess. The latter taxpayer has available many devices for reducing his tax liability which are not available to the small taxpayer. An illustrative, but by no means all-inclusive, list of means by which in actual experience the large tax rates are made less effective, follows:

Investment in tax-exempt securities is an important tax shelter. The small taxpayer finds their yield small, and the supplemental yield to him through tax savings insignificant. The large taxpayer finds the nominal yield supplemented by a very valuable tax exemption, and the result is a considerable concentration of holdings of tax-exempt securities among those having the larger incomes.

When Congress, therefore, writes rates such as apply to the wage earners, salaried men, the small businessmen, or the professional men, it may be sure that most of them will pay legal rate upon their entire net income. When considering the rates in the higher brackets, however, it must be remembered that they will apply to but a part of the taxpayer's actual income, for the taxpayers in the higher brackets, according to our studies, commonly have large tax-free incomes often equal to, or in excess of, taxable incomes. By reason of this fact rates apparently severe are in fact moderated, and to some extent made ineffective.

We have analyzed the 1932 returns of the 58 taxpayers whose gross incomes for that year exceeded \$1,000,000; 20 of them had net taxable incomes exceeding \$1,000,000.

The information is incomplete. While the regulations require that tax exempts shall be reported, although not taxed, a substantial number of taxpayers, including some of the largest, failed to return any information. The figures that we use, therefore, understate the extent of avoidance through tax-exempt securities.

The 58 taxpayers reported the ownership of \$461,000,000 tax-exempt securities and a tax-free income therefrom in that year of \$21,000,487, as against a taxable income of the group amounting to \$57,015,000. The exemption on this group cost the Government in 1932, \$11,866,000 in taxes. This study indicates that our tax laws wholly fail to reach about 37 percent of the income actually enjoyed from all sources by those whose incomes are over a million dollars a year.

The study also reveals gross inequalities of taxation between the well-to-do taxpayers of really similar position and income. We have prepared a study of the effect of tax-exempt securities upon the 58 gross incomes exceeding \$1,000,000 in 1932, with the taxpayers identified only by letter; and we shall be glad to submit this study.

Gross inequalities between taxpayers are found. For example: Taxpayer D had a net income of only \$101,050 with tax-free income of about \$1,400,000. He wiped out the net income that would have been taxable with capital losses, and paid no tax whatever.

Taxpayer F, out of \$2,700,000 of gross income, reported only \$20,000 net, with about \$290,000 of tax-free income. An examina-

tion by the Bureau indicates that his report was somewhat modest and that additional taxes of over \$600,000 were due.

Taxpayer A, out of \$22,000,000 of gross income, had \$5,200,000 of—net and about \$4,300,000 of tax-free income.

Taxpayer TT reported \$141,000 of net income, but had over \$800,000 of tax-exempt income. On the other hand, Taxpayer QQ had a gross income of \$1,199,000 and a net income of \$1,194,000, reported no tax-exempt securities, and only \$5,000 difference between his gross and his net incomes.

Of the refuges from high taxes, the tax-free income is the most effective and least to be criticized so long as our laws allow it. But the effect that tax-exempt securities have by way of nullifying tax rates may well be considered in fixing rates upon that part of income which is taxable.

Big taxpayers also reduce their taxes by obtaining allowances as business losses, of the expense of show farms, ranches, racing stables, and hobbies, which are in fact amusements and recreations. This is done by asserting the hobby is a business, entered into solely for profit, and the courts have generally sustained such claims when well sworn to.

A study of the tax savings of a few of the many such cases has been made, the taxpayers' names being omitted and letter used for identification, and if the committee thinks it helpful this study will be submitted.

Senator LA FOLLETTE. I think, Mr. Jackson, that you ought to submit both of those studies on tax-exempt income and on this other feature, and then the committee can determine whether it should be incorporated in the record or just filed with the committee.

Mr. JACKSON. I will be glad to do that.

Taxpayer A has for years pursued a hobby, the expense of which greatly exceeded receipts, and in each of the last 2 years his loss was close to a million dollars. In one year he made the Government stand \$166,888 of his hobby expense by reducing his income taxes in that amount.

Taxpayers B, C, and D are three such distinguished farmers each of whom has regularly lost from \$150,000 to \$200,000 a year on their farms. In the last 5 years, B has reduced his taxes \$221,000; C, \$210,000; and D, \$206,000 because of farm losses. Such "farm relief" is not available to smaller payers who cannot deduct for their hobbies or amusements.

The privilege of postponing tax on increase of value of assets by using the forms of corporate reorganizations, like the device of creating a fictitious realization of losses, is practically available only to those of the higher income levels.

The lower levels of income are derived largely from wages, or salaries, or personally conducted businesses or professions. Much income of the larger income classes arises from gains realized in the value of capital assets. Our income-tax law has been so devised and administered as to permit the forms of corporate reorganization to be used for stepping up of wealth without the payment of tax.

The privilege of corporate reorganization without the recognition of a gain or loss has been abused and taxpayers, whose affairs are sufficiently large and so ordered that they can use it advantageously, have been able to convert their assets into essentially different values

and often to hand on at death the securities representing the stepped-up value with no income tax ever having been paid upon the increase. This, incidentally, is true of all capital gains that are not realized prior to death—such gains escape income tax entirely.

Senator KING. In your investigation, did you discover that there were large capital losses?

Mr. JACKSON. Of course, very large capital losses.

Senator KING. There have been enormous capital losses since 1929, have there not?

Mr. JACKSON. Certainly.

Senator KING. Which wiped out many properties?

Mr. JACKSON. Wiped out many properties and wiped out many incomes.

Senator KING. And forced many organizations as well as individuals into the bankruptcy courts?

Mr. JACKSON. There is no question about that, Senator. There are very many tales of disaster in the records of the Internal Revenue Bureau.

Senator KING. Have you made any estimate based upon your investigations as to the capital losses in the past 3 or 4 years?

Mr. JACKSON. The capital losses can be given to you very quickly. I do not have them here, but we can get them for you. That is, the capital losses claimed on the income-tax returns. Of course, capital losses suffered by people who do not make income-tax returns, whose equity in their houses has been wiped out or something of that sort, does not appear in our statistics.

Senator KING. So that the statistical information would not be complete?

Mr. JACKSON. It only begins at a certain level of income. That is the trouble with it.

Senator KING. And below that level, of course, there are many casualties?

Mr. JACKSON. Below that level there are, I think, some of the most desperate ones.

Senator KING. That would be evident by the applications which have been made for loans to several agencies to save homes and loans to save farms?

Mr. JACKSON. That is right.

Senator KING. And evidenced by the number of recent foreclosure proceedings which have been brought?

Mr. JACKSON. Those things do not come into our records because the basis on which the income tax applies is so small that it only reaches at most six or seven million people. I think the highest number of returns ever filed was only about 7,000,000. So that the fortunes and misfortunes of the classes below that are not revealed by our statistics.

Senator KING. The failure of the banks and the failure of mining companies and many other corporations, manufacturing institutions, are indicative of the casualties which have been sustained and the capital losses which have resulted during the past few years?

Mr. JACKSON. That is true, of course. Statistics could be obtained, of course, and are no doubt available as to the losses through bank failures, capital losses sustained by depositors.

Senator KING. By the owners of stock?

Mr. JACKSON. Yes. Probably available by some segregations that could be made as to the size of the deposits; at least an estimate could be made as to the percentage of bank deposits that were lost by people whose deposits were under a certain figure. If the committee would desire that, we will see what we can get on it.

Likewise, it has been mainly taxpayers in the high levels of income, who have been able to have their cake and eat it too, through fictitious or shadow sales of assets by which they record a loss for tax purposes but never actually part with the control or beneficial enjoyment of the asset claimed to have been sold.

Capital losses, not all of them have been actual losses. We find that the capital loss is one of the devices which has been used during the declining period to reduce taxes without ever actually parting with the control of the asset upon which it is claimed the loss has been realized.

Senator LA FOLLETTE. How has that been done? Will you give us a typical example?

Mr. JACKSON. A man has \$100,000 worth of securities, and he records a sale to his secretary at \$50. They are not listed securities; they are the securities in some company that he is interested in. She has an income of \$20 a week. Thirty days later she sells them back to him. She never knew that she owned them.

We have had just that case, absolutely fictitious.

And sales to banking institutions. Some banks have run a more or less regular business of purchasing securities and selling them back after 30 days for the same price plus interest.

The cases that we are trying in which we are challenging those obviously fictitious transactions will indicate both the extent of it and the difficulty that you have in overcoming it.

Senator GERRY. Would you be inclined more to turn to the English system, which I understand has no capital gains or capital losses? We had that up in the committee away back, if I recollect correctly, many years ago, and there was a great deal of discussion of it within the committee.

Mr. JACKSON. We have turned in the direction of half of the English system, I think. We have turned in the direction of disallowing capital losses but taxing capital gains.

Senator GERRY. Of course that is very nice for the Treasury.

Mr. JACKSON. The greatest difficulty with the capital gains, of course—the greatest difficulty we have is connected with the capital gains. If we had the British system, a large part of the difficulties of enforcement would immediately vanish.

However, on the matter of policy, there is a good deal to be said for taxing the gains which accrue to a man through economic conditions rather than his own effort, and I do not think that I would want to see personally, capital gains exempted from taxes.

Senator GERRY. I can well understand how that would be the Treasury attitude, but the English have carried out the other theory. Whether that is sound or not, I am not prepared to say.

Mr. JACKSON. I think that is a problem of policy. It is hard to say if you apply both ends of the capital gain and loss provisions, allow the losses as well as the gains, it is hard to say, over a long period of time, just what the effect on the Treasury would be.

Senator GERRY. The English wanted to get as much money as they could. They taxed very heavily, and therefore they must also have had that in mind. On the merits of the case, I am not prepared to say. I was just interested, because we have had that up for consideration.

Mr. JACKSON. Of course, capital gains in a man's income produce very great fluctuations of income. He may have a normal income from his earning capacity of \$25,000 a year, for example, and suddenly realize a very large capital gain, which throws his income for that year out of balance.

Senator GERRY. I understand that, but what I had in mind was why the English eliminated it, because they are very practical people, and they want to get as much revenue as they can.

Mr. JACKSON. Yes; and they have a very excellent system. They eliminate capital gains and losses, and they also eliminate many deductions, and the deductions which they have eliminated are the deductions which have given us the most trouble in administration.

Senator GERRY. That is not answering my question. Why did they eliminate it, where they need the revenue so badly?

Mr. JACKSON. I think they did it on several theories; one is the difficulty of administration; the other is they think it is unfair to the taxpayer because it produces the fluctuation of income which I pointed out to you, and they favor more taxing on an average of earnings. That is to say, to apply the tax more to a man's average than to hit him in the peaks and then slump off in the depression.

And also, I believe, that the British have contended—I have never verified the figures—that the Treasury itself was not greatly advantaged by the capital-gains tax, because they had to allow so many losses to offset them.

Senator KING. Is it not a fact that after a very searching examination extending over a series of years, the British adopted a plan which has just been suggested of not taxing capital gains or losses?

Mr. JACKSON. That is right.

Senator KING. They held that the one hand washed the other, and the administrative difficulties to which you have referred was one of the inducements, to say nothing of the question of the inequities and injustice, and these have led them to the abolition of it—that is taxing the gains and not deducting the losses.

Senator GERRY. And they probably felt in the long run that they were getting more money out of it?

Mr. JACKSON. Of course, you are applying the British law—I do not need to say it to you—to a quite different economy. It is a very different situation in England. The secondary objects of their taxation affect these landed estates in quite a different degree.

Senator GERRY. That is going into a different problem. I understand that fully and I understand how they operate their tax laws. They have an entirely different tax law.

Senator KING. They have never taxed gains.

Senator GERRY. They have never taxed gains and I have often wondered why they did not adopt our policy.

Mr. JACKSON. They have made extensive studies on it, and extensive studies of ours, too, and its operation here as well, and they stick to their own plan, but they have, as I say, quite a different economy. Their history is developed under a different theory.

Senator COSTIGAN. The case that you cited in answering Senator La Follette a few moments ago, did the employer claim a loss in the sale to his secretary?

Mr. JACKSON. Yes.

Senator COSTIGAN. Was the Government unable to challenge that transaction?

Mr. JACKSON. We have challenged it; we do not know what the result will be.

Senator COSTIGAN. The result has not been determined?

Mr. JACKSON. There are hundreds of those cases under challenge at the present time, and the law is gradually being made. The Government wins some of the cases and loses some of them.

Senator KING. Is it not a fact that because of the mercurial condition of stocks and the great losses which have been realized, at least on paper during the past 2 or 3 years in stocks, that it is very difficult to determine just where there have been capital losses and gains intrinsically and per se?

Mr. JACKSON. The law adopts a certain standard for allowing loss. One's stock may diminish in quoted value, but unless he realizes the loss through the sale, he is not entitled to take it, and he is not chargeable with a gain just because the stock market goes up, unless he realizes the gain by a sale.

The whole question is the good faith of the sale. If there is an actual sale, then of course he is entitled to his loss, or the Government entitled to its gain if it is actual. But if the sale is merely a matter of record and not a matter of real fact, then he is not entitled to it. That is the position which we have taken.

The difficulty of course is that there was a psychology that it was perfectly right to make almost any kind of a record and take the benefit of it on your tax return, and undoubtedly some people who did that, did it in the belief that it would get by. I think there is very little of it going on at the present time. My judgment is that it is pretty definitely stopped.

Senator LA FOLLETTE. How do you account for that, Mr. Jackson?

Mr. JACKSON. I think that the trial of some of the cases had the effect of calling the public's attention to the uncomfortable position, to say the least, of those who have engaged in it. Many people have paid their taxes when we have asserted deficiencies.

Then, of course, the law has been changed as to the effect. I think today it is not as serious a problem as it has been, although, of course, as long as capital losses are allowed there will be attempts to sell without actual good-faith sales.

Other avoidance or evasion devices to reduce the effective tax rate, of which there are many within or upon the border line of the law, are available only to substantial taxpayers, because of the cost of lawyers and machinery. Many of them would only be worth utilizing if the amount of property involved were large. Corporations cannot be created, and property split, and trusts established to maintain children unless the amounts involved are large enough to warrant the trouble.

In analyzing one case, we found 197 trusts set up in one family. We have not completed the study yet, but the purpose of these trusts was very obviously to create separate taxing units which would get away from the surtax. Different trusts were created with slightly

different terms set up as different taxing units for the purpose of return and taxes.

The evasion devices of those of moderate means are usually crude, based on curbstone or inexperienced advice and accomplished with the aid of members of the taxpayer's family or immediate employees. Information as to such transactions is easy to obtain, and banks and others will not try to shelter him. Tax-evasion plans of the extremely rich taxpayer, however, are often planned over a period of years by a clinic of able counselors and with the cooperation of many corporations, banks, and individuals. His affairs can only be deciphered by examining and matching up the books and records of many corporations and individuals, and information is difficult to obtain. The two groups present fundamentally different problems in enforcement. We are successful in dealing with minor evaders, but the tax-evasion schemes of rich men sometimes come to light only accidentally, and present the utmost difficulty of solution in the face of a general conspiracy of their associated and controlled corporations to suppress information.

The device of permitting a litigation of tax first and payment afterwards, with no security, or penalty or disadvantage whatever for the delay is proving so costly as to present a challenge to effective enforcement.

It is stated by a retiring member of the Board of Tax Appeals that since 1926 the Government had lost two-thirds in amount of its cases before the Board of Tax Appeals, the average tax case involving a deficiency of \$28,000.

This result before the Board of Tax Appeals contrasts with the result in the Court of Claims and the United States district courts where the taxpayer must first pay his tax and then sue for refund, and where the Government appears to win a much larger percentage of the cases.

For the year ended June 30, 1935, trials in these two courts showed the following results:

Decisions in favor of the Government, or dismissals on the basis of decisions in favor of the Government, 252; amount claimed, \$16,801,896.

Decisions in favor or partly in favor of the taxpayer, or confessions of judgment on the basis of decisions in favor of the taxpayer, 135; amount involved, \$555,479.

Almost a complete reversal of the percentage where they pay first and sue for a refund that exists, as against where they do not.

In addition to this, 151 cases involving \$9,949,000 were dismissed by the taxpayers without refund.

Senator KING. Mr. Jackson, do you think that the permission given by the statute or the Treasury Department or the Treasury officials will automatically or ex parte insist upon an additional assessment, as made for increased litigation and accounts for the fact that so many of the cases were lost?

Mr. JACKSON. I think there has been at times considerable carelessness in sending out deficiency letters. There are times when you are obliged to send a deficiency letter by guess because they won't give you the information. That happens in an astonishing number of cases. Where you simply are refused or they had not kept the information, you therefore send out the largest assessment that is at all likely and make them produce their evidence before the board.

Senator KING. Many of those deficiencies were sent out hurriedly for fear that the statute of limitations would run?

Mr. JACKSON. Sometimes we find that situation forcing our hand. I would be the last person to advocate that there should be no review of the Commissioner's deficiency letters. I think there should be an impartial review. It may be that there are persons capable of detaching themselves from their duty and achieve impartiality. I am not one of them. I think that the taxpayer is entitled to a neutral mind to pass on his claim, but I do not believe that we can successfully administer the income-tax laws much longer if we are going to permit the taxpayer without the payment of anything except a \$10 filing fee, to get 3 or 4 years' delay in the payment of his deficiency.

Senator KING. Do you not think that an increase of the penalty in the shape of interest would have something to do with deterring the prolongation?

Mr. JACKSON. I do not think that the interest enters into it very much. In the last few years, Senator, a great many of the taxpayers were in effect borrowing from the Government when they could not have borrowed from the banks at any figure, and I do not think that the interest has been for the last 4 or 5 years the controlling factor.

The difficulty with a penalty rate of interest is that the man who has a perfectly legitimate objection to the Commissioner's letter is penalized with it just as much as the man who is simply appealing for delay, and the cost to the Government in the loss of revenue due to the fact that in 3 or 4 years of delay, the taxpayers have failed or have transferred their assets by various means, has been very heavy. This is an extremely costly method of collecting income tax.

Senator KING. It is not germane, but is it true that the Government has lost a great deal by reason of delinquent taxpayers being in the bankruptcy court?

Mr. JACKSON. Oh, yes. Bankruptcy and receivership overtake a great many taxpayers, and while there is a preference, a priority of payment to the Government, very frequently it is impractical to enforce it, because the allowances made by the courts for the preservation of the estate, attorney fees, the fees of the trustee in bankruptcy, the fees for the receiver, all come up to where the Government, even with its priority claim, does not get anything.

The reorganization provisions of the statute are causing, of course, a great many applications for compromise of tax liability.

Senator LA FOLLETTE. What would you suggest that will remedy it?

Mr. JACKSON. I think we must create an independent board to pass on these deficiencies, and that the taxpayer be required by the Commissioner to furnish some kind of security. So that we are not litigating to find at the end of the road that it was worthless at all times, and that there must be some provision, either requiring him to pay the tax or give security, so that the appeals for the simple purpose of delay can no longer be taken.

We are having a very careful study made of this situation to find out just where the difficulty lies. At the present time I do not think I would be prepared to express a conclusion that I would want to stand by as to all of the changes that ought to be made.

The problem of enforcement is a very serious problem. We have general statistics showing a decrease in the number of cases, and I can show statistical figures of decrease in the past year, but there is

not a decrease in the actual work, because the little cases get tried and the big cases get stalled. We have one case in Los Angeles that has been on trial a year.

Senator KING. Constantly? The court has been in session 1 year trying one case?

Mr. JACKSON. One year; that is, counting the vacation. They started last September.

Senator COSTIGAN. How much is involved there?

Mr. JACKSON. A very large estate. It is the estate of Huntington, and involves quite a number of parcels of property. I make no criticism of the men who are conducting the case. I do not know of any way they could speed it up, but that is that situation that we have run into on this valuation of properties, and it becomes increasingly important as the rates go up, because valuations will be contested that would not be contested if they had less tax significance, and we must prepare in connection with these things a stronger administrative machinery if we are going to be effective.

Senator KING. It is not germane to the question under investigation, but having had something to do with the creation of the Board of Tax Appeals, has that served any very useful purpose?

Mr. JACKSON. It has served a useful purpose; yes.

Senator KING. Has the day come when it might be abolished?

Mr. JACKSON. The day has come when it is totally inadequate to the problems which it must solve. The Board of Tax Appeals decides in litigated cases about 1,600 cases a year, and we are having 4 or 5 or 6 thousand cases a year commenced. With that situation, where we are compelled to settle two-thirds of our cases, we are not getting the best results in the settlements, of course. We are under pressure, and there must be either an increase in the capacity of the Board of Tax Appeals or some other device for accomplishing the same purpose.

It is possible that the Board of Tax Appeals could sit through an examiner as the Court of Claims and the Interstate Commerce Commission do. It is possible to add more members, it is possible to make an entirely different set-up.

We are making a study of the results with a view to making a recommendation on that subject at a later time.

Senator KING. You know that in Great Britain they do not have all of this machinery that we have. One man sitting there in a little bit of a room will decide these cases, plus the decisions which emanate from local organizations, and they do not have this litigation and these millions of dollars expended in court fees and what not extending over a period of years. Do you not think that we might emulate a little or imitate a little more, the British system of dealing with the collection of taxes?

Mr. JACKSON. That is true, Senator, but you will find it is largely due to the difference in the provisions of the law. Their law in England has little depletion or depreciation. We have no end of litigation over just those deductions. They do not pass on capital gains, they do not tax them, nor allow capital losses, and that accounts for the very large part of our litigation.

It would be a wild guess, but I think that if you would eliminate from our litigation, the litigation over subjects that do not arise under the law in Britain, that you would find that our litigation would not compare unfavorably with theirs.

Senator KING. They have very little litigation, very little.

Mr. JACKSON. But it must be borne in mind that they have a very much larger administrative staff in proportion to the number of taxpayers, and that a part of our litigation results from inadequate investigation and the inadequacy of the study made before a deficiency letter is sent out. That is the time they ought to be studied.

Senator KING. I think the organization with which Mr. Parker is connected, the Joint Committee on Taxation, will be very glad to take this question up with you and your organization and see if he cannot make some recommendation.

Mr. JACKSON. Mr. Parker and his associates made a very admirable study of this English system, and unquestionably on the administrative side of it, it contains a great many valuable suggestions.

Senator KING. You may proceed. I think perhaps we have taken too many detours.

Mr. JACKSON. I was going to give you some of the figures on this situation.

It is obviously, if the ratio of losses by the Government in cases before the Board is accurately stated, a great advantage to petition for redetermination where the taxpayer can afford it. The Board has capacity actually to decide only about 1,600 contested cases a year. We have in recent years reduced the number of cases pending, but the amount involved in undecided cases has increased. July 1, 1934, we had 12,474 cases, involving \$448,493,060 pending, and on July 1, 1935, we had 10,423 cases pending, involving \$493,648,417. Thus while reducing the number of cases by 2,051, the amount of asserted deficiencies held in suspense increased last year \$45,155,337.

Senator KING. Was that largely by reason of the difficulties growing out of losses through the depression, and consolidations and receivership and so on?

Mr. JACKSON. I would say not. I would say that it was due to the fact that in the drive and in the anxiety to get rid of a large number of cases, there has been a tendency to pick the case that was easy to prepare and quick to try. The result of it is that we have cleaned up small cases and the large ones have accumulated. The Board just has not the capacity.

It has been estimated that, by men closer to the litigation work than I, that we have about 50 cases each of which will require 6 months of steady trial work to take the evidence. When you lay that alongside of the capacity of the Board of Tax Appeals and realize that you would only get rid of 50 cases out of 12,000 by that effort, you see the jam that this income-tax enforcement is in under the present machinery.

This situation is one of utmost gravity and one as to which, when speaking of the income tax, we could not accept the responsibility of silence.

The foregoing are merely illustrative of some of the major methods by which the rates in higher levels are rendered partially ineffective, and indicate that increased rates and revenues may properly be sought in those brackets to equalize the burdens of taxation and apply the principle of taxation according to benefits received and resulting ability to pay.

INHERITANCE AND GIFT TAXES

Now, going into the subject of inheritance and gift taxes—the taxation of inheritances and gifts is not, as many have assumed, a new field of taxation by the Federal Government.

Inheritance taxes, as you all know, have for a long time formed a part of many States' tax structures; but there is a tendency to overlook the historical development of Federal activity in this field of taxation. Shortly after the formation of the National Government, on July 6, 1797, Congress passed chapter XI (1 Stat. 527), which provided among other things for a death duty by the imposition of stamp taxes upon receipts for legacies and shares of personal property. This tax provision remained in effect until June 30, 1802. On January 21, 1815, Secretary of the Treasury Dallas recommended inheritance taxes as a war finance measure; but inasmuch as the war with England was ended soon thereafter his proposal was not acted upon. During the Civil War period, three types of death taxes were put into effect, namely, legacy, succession, and probate duties. In 1871 the legacy and succession duties produced about two and a half million dollars.

Congress by the act of August 27, 1894, taxing incomes treated inheritances as income. Had it not been for the reversal of position of the Supreme Court by the change of one vote so as to hold the entire income-tax law unconstitutional on the ground that it levied direct taxes not proportioned to population, we would have started American income-tax practice, by adding sums received by inheritance to ordinary income and taxing the whole at income-tax rate.

Under the War Revenue bill of June 13, 1898, a tax was imposed upon distributed shares based upon the size of the estate of the decedent and limited to personal property passed by will or intestate laws, or by transfers intended to take effect at death. This law was a cross between an estate tax and an inheritance tax, but the construction of the Supreme Court made it in effect an inheritance tax.

In 1916 Congress shifted from an inheritance basis to a genuine estate tax. A gift tax to support the estate tax and to prevent avoidance was enacted in 1924, but was repealed 2 years later. In 1932 the gift tax was reenacted to supplement the estate tax.

In spite of the Federal Government's varied experience with inheritance taxes, there is no existing basis upon which we feel accurate long-term estimates of true yield can be made. The estimates submitted may be regarded as safe minima but it must be borne in mind that the effect upon the revenue lags at least 2 years behind the enactment of legislation, and that the true yield of an inheritance and gift tax can be determined only after the law has been in effect long enough to overcome disposition of property which anticipate and defeat new taxes.

For example, before the enactment of the gift-tax law of 1932, and while it was under consideration, many transfers were made by persons of large property to reduce their taxable estates and avoid the coming gift tax. Two taxpayers transferred upward of \$150,000,000. We now have an estate before the Bureau reported to be worth only \$8,000,000 from which, within 2 years of death and just before the gift tax became effective, the heirs received gifts of upward of \$50,000,000.

For some period following the enactment of a gift tax or inheritance tax, the revenues from it are likely to be low because its enactment will have been anticipated and avoided. After the gift tax was signed in June of 1932, the 1933 revenues from that source were only \$2,241,899. In 1934, however, one single gift tax was paid in the amount of \$18,802,978.

The principles upon which the taxation of inheritance is distinguished from the taxation of the estate as a whole are well understood. While the estate tax has simplicity of administration in its favor, the inheritance tax is more truly based on ability to pay and on benefits received, in that the tax is proportioned to the amount actually received by the legatee, while the estate makes no discrimination between an estate divided between, say, five heirs and one passing to a single heir.

The principal questions that have been raised relate to administration, such as collection problems, hardship on going business and valuation.

We see no serious difficulties in the way of administration of inheritance taxes. The estimated total number of inheritances of \$1,000 and over is only 161,755 per year at the present time, as compared with individual income tax returns filed for 1933 in excess of 3,700,000.

You see that the inheritance and estate tax is a relatively small problem in the number affected.

From the figures of income already given you will see that the prospect of accumulating sizable estates is a hope to the many, and a realization to but few. Furthermore, all inheritances of any substantial size are matters of court record.

I may say that that phase of the problem is very, very much less due in part to the fact that it is a matter of court record and in part due to the fact that oftentimes executors are relatively disinterested persons who are interested in administering the estate according to the law.

Senator KING. Of course, it is a matter of record with respect to the estates?

Mr. JACKSON. Yes.

Senator KING. And if you are contending that the administrative difficulties are less with inheritance taxes because of the court procedure, you have the court procedure with respect to estates?

Mr. JACKSON. That is true. It is all a matter of record. I mean by that that income is a difficult thing to ascertain, but with estates you have under the supervision of the local court, an inventory made and the debts ascertained. It is a much simpler problem from the point of view of administration than the income tax.

The Treasury has made a rough estimate of the distribution of inheritance based upon the United States 1935 estate values after deduction of Federal estate taxes, and I would like to put that statement into the record.

Senator KING. It may be done.

(The statement is as follows:)

Estimated distribution of inheritances, United States 1935 estate values (after deduction of Federal estate taxes)

Average inheritance (in thousands of dollars)	Number of returns	Amount in class (in thousands of dollars)	Average inheritance (in thousands of dollars)	Number of returns	Amount in class (in thousands of dollars)
1.55.....	33, 136	51, 361	136.96.....	1, 120	153, 390
4.27.....	18, 197	77, 701	185.98.....	452	84, 061
7.40.....	46, 008	340, 459	239.60.....	272	65, 171
12.67.....	24, 954	316, 084	286.76.....	108	30, 970
15.17.....	14, 296	216, 885	337.29.....	156	52, 617
21.05.....	7, 220	151, 981	426.35.....	76	32, 403
27.07.....	3, 944	106, 748	507.35.....	40	20, 294
32.85.....	2, 772	91, 049	640.29.....	40	25, 612
40.90.....	3, 252	132, 994	803.97.....	4	3, 216
51.83.....	1, 976	102, 416	976.10.....	24	23, 426
62.51.....	1, 224	76, 512	1,270.35.....	20	25, 407
79.73.....	1, 604	127, 887	1,755.55.....	20	35, 171
100.71.....	840	84, 595			

Senator LA FOLLETTE. Just what does it show?

Mr. JACKSON. It shows the number of inheritances in each group that we may expect, based on estates values returned in 1935. It contains some very arbitrary assumptions. You have to assume the average number of heirs, for example, to get at the number of inheritances, and there are assumptions of that kind.

It is the best estimate that we can make. It shows, for example, that there were 33,136 returns that will indicate inheritances of \$1,500. That many inheritances will be anticipated.

On the other thand, we would anticipate on the basis of existing figures, 20 inheritances of \$1,758,000.

The purpose is to bet at the spread of probable estates so as to estimate the others.

Much has been said of the difficulties involved in liquidating large estates in order to pay taxes imposed at high rates. Unquestionably, some estates are so situated that liquidation is difficult, long delayed, and accomplished only at sacrifice. Where estates are frozen or embarked in hazardous enterprises, unquestionably difficulties will arise which will require sympathetic administration on the part of the Bureau, if hardship is to be avoided.

Legislation, however, must have regard for the general condition rather than for the exceptional. Examination of the data as to the composition of estates filed under the Federal estate law during the calendar years 1932 and 1933 indicates that the difficulty of liquidation may be exaggerated. This table follows:

Gross property of estates as reported under the Federal estate tax law

	1932		1933	
	Amount	Percent	Amount	Percent
Real estate.....	\$433, 374, 000	15. 5	\$385, 831, 000	19. 1
Securities.....	1, 548, 414, 000	55. 4	1, 075, 178, 000	53. 0
Mortgages, notes, cash, insurance, etc.....	476, 460, 000	17. 0	457, 271, 000	22. 5
Miscellaneous.....	337, 571, 000	12. 1	108, 651, 000	5. 4
Total.....	2, 795, 819, 000	100. 0	2, 026, 931, 000	100. 0

I think it is important enough so that I will read the main divisions. In 1933 real estate constituted 19.1 percent of the assets reported; securities, 53 percent; mortgages, notes, cash, and insurance, 22 percent; miscellaneous, 5 percent. The foregoing figures for 1932 relate mainly to estates of persons who died in 1931.

It is to be noted that 55 percent of the property comprising gross estate was in the form of securities with accounts, notes, cash, and insurance accounting for an additional 17 percent of the total.

Senator LA FOLLETTE. Mr. Jackson, before you leave this question of hardship upon large estates, in the criticism of this proposal for inheritance taxes in general, there has been reference made to the difficulties of situations so far as the Ford Co. is concerned. Of course, I would not ask you for any information that you have as a result of the Treasury's information, but have you any information from matters of public record which you could not be criticized in any way in giving, which would help to give us a true picture of this pathetic situation that is often pictured in connection with the enforcement of the inheritance tax.

Mr. JACKSON. After Senator Lonergan asked the question the other day in the hearing, and after some of the publicity that I saw on the situation, I prepared to give to the committee if it desired, a statement covering that situation, and I can give it now.

Questions have arisen in these hearings and in the press as to the application of the proposed inheritance tax to such an estate as that of Henry Ford, and its effect upon the Ford Motor Co.

It would be unlawful to make public the figures of the Internal Revenue Bureau, for there is no way in which we can discuss this singular American fortune without identifying it. We will, therefore, use figures reported by the Ford Motor Co. to the Massachusetts commissioner of corporations, and other publicly available information, and without any endorsement of accuracy.

The information is found in the standard statistics in Moody's Manual, and publications of that kind.

The 1934 report of the Ford Motor Co. to the Massachusetts commissioner of corporations indicates a net worth of approximately \$600,000,000.

Edsel B. Ford, it is stated by reliable sources, in 1919, acquired 41½ percent of the outstanding stock of the Ford Motor Co. Henry Ford, therefore, does not own more than 59 percent of the stock of the Ford Motor Co., and the inheritance tax could only apply to what he retains.

Edsel Ford has already received an interest in the Ford Motor Co. now worth on the balance sheet \$246,000,000. This is not touched by inheritance or estate taxes. This illustrates concretely what I have stated to be the general rule. I have not stated it yet, but I point it out here that estates do not pass from rich men to poor men, but usually it is the fact that these heirs are amply provided for.

An estate of \$354,000,000, the balance sheet value of the remaining 59 percent of the stock which we will assume Mr. Henry Ford still owns, is abnormal by any test we know. The House bill, intended to cover most normal estates, stops graduation entirely at \$10,000,000 and the Ford estate, on those figures, would be 35 times the point at which graduation of rates ceases. The largest estate so far returned to the Bureau of Internal Revenue was \$140,000,000. It is obvious

that the hypothetical application of this law to the Ford fortune would be a distortion of its usual application.

Moreover, while the Ford Motor Co. has been accumulating its surplus at an average rate of \$20,000,000 a year, this amount has not been distributed to stockholders where it would be subject to surtaxes. The increase in value of the holdings of Henry Ford, if realized upon by a sale in his lifetime, would pay heavy individual taxes. If it now passes by inheritance it will have escaped all surtaxes. Thus if the heirs of Henry Ford shall now find themselves in high inheritance tax brackets, it is in part offset by the advantages of accumulating wealth without paying surtaxes thereon.

It is impossible, on the basis of published figures, to arrive at a reliable estimate of the tax that might be imposed upon the estate of Henry Ford. We do not know how much of his holdings will remain in his individual possession and subject to tax or how much of them will pass to organizations that are exempt from tax, nor what part of them will pass to his son and what part to others.

The inheritance tax, whatever its amount, would not be a tax on the Ford Motor Co., nor a claim against it. According to public statements, the Ford Motor Co. began business in 1903 with \$28,000 in cash actually paid in, and its net worth of \$600,000,000 in 1934 represents the accumulations after the payment of dividends. Over this period, the Ford Motor Co. has added to the book value of its stock through accumulation of surplus an average of roughly \$20,000,000 a year. It is obvious that a corporation with this record is not to be abandoned or closed because of any tax on the right to inherit its stock.

The utmost to be anticipated would be that some part of the equity now represented by the common stock would be sold to other interests or to the public. This equity might be disposed of in part through a bond issue, or through preferred stock, or by a sale of a portion of the common stock. The effect of this would be to convert what is now a family industry into a widely owned one, and to permit the public to share in the future earnings of an enterprise to the building of which public patronage has made a substantial contribution.

The Ford case presents perhaps the worst example that can be selected of hardship of this tax. There are estates that are so invested that the enforcement of this tax, the inheritance tax, would be a difficult thing; there is no use in anybody dodging that.

Senator KING. Are there not a number of estates which under the State estate taxes and then the Federal estate tax and the Federal inheritance tax, if this were to be enacted, would take all that there was?

Mr. JACKSON. I do not know of any such, and I have inquired in the Bureau of men who have much longer experience there than I, and they do not know of any such, and I have tried to find a business that was closed by the present taxes and I cannot find one.

Senator KING. We have not the inheritance tax at present.

Mr. JACKSON. I say, by the present tax. Of course, we have been through the most difficult times to test an estate tax as to possibilities of liquidation amounts that we hope we will ever see in our lifetime. I certainly do not want to go through it again, and I think that the examples which we frequently hear of the effect of taxes are very

much exaggerated, because in every one of those cases that I have been able to get anyone to identify so that I could trace it into the records, we found that the estate was so involved in debts that it would probably have had difficulty if it had not had any taxes.

Of course, if an estate is invested in frozen assets or worse yet, if it invested in equities with mortgages ahead of it, it could not liquidate during the past few years under any circumstances, tax or no tax.

Senator KING. Is it not a fact that a number of estates having some indebtedness and being subjected to the State taxes, because the assets are in a number of different States, plus the Federal tax, have been unable to meet their obligations and have become insolvent, and the heirs have received nothing whatever?

Mr. JACKSON. Many estates have become insolvent; many estates have been unable to meet their taxes. From many estates, the heirs have received nothing. But the proportion of that difficulty that is caused by taxes, and the proportion that is caused by the debts and involvements of the estate would be a difficult thing to appraise, but I think the instances that are sometimes cited, if you will just identify them enough so that we can go to the records, we will be able to show you in nearly every instance that the fault was not primarily with the tax.

Senator GERRY. That is when you had 75 percent of the present tax.

Mr. JACKSON. Not 75 percent inheritance tax.

Senator GERRY. So you have no figures to go on?

Mr. JACKSON. No.

Senator GERRY. You are just going on your personal opinion?

Mr. JACKSON. I am not even doing that. I do not offer my personal opinion as to the difficulties you will have in the future. I am confining it to the experience that we have had up to the present moment with estate taxes.

Senator GERRY. Which does not cover a situation such as this?

Mr. JACKSON. It does not cover the situation with an inheritance tax, and obviously there is no general rule that we can lay down as to the difficulty that will be encountered, because it depends upon the composition of each particular estate.

Senator GERRY. Of course, you recognize, that the higher you make the tax, if you go from 75 to 95 percent, you will have even more difficulty?

Mr. JACKSON. There is no doubt about that.

Senator GERRY. And if you go to 98 percent—

Mr. JACKSON (interrupting). Every dollar of debt or every dollar of tax that must be taken out of the gross assets of the estate, adds to the complications and adds to the probability that the estate will not be able to pay it.

Senator GERRY. That the tax will be over 100 percent.

Mr. JACKSON. I do not see how the tax could become over 100 percent.

Senator GERRY. You do not? I do.

Mr. JACKSON. The inheritance tax would not apply except to the net estate as distributed, and if there was nothing to distribute, there would be no inheritance tax.

Senator GERRY. You would have to collect to distribute.

Mr. JACKSON. If you include shrinkage on liquidation as a part of the loss, then I am unable to say that it would not, in many cases.

Senator GERRY. You have to, certainly.

Mr. JACKSON. Because if an estate invested in real-estate equities at the present time or any time during the past few years, during the past 5 years, let us say, of course it would present an almost impossible problem. If it were invested in Government bonds, it would present a totally different problem. It is a matter of ratios that I do not think we can lay down any general rule about, and each man's experience will have to guide his own opinion.

Senator GERRY. You are not asserting that a 98-percent estate tax might in very many, in 99 cases out of 100, be confiscatory of large estates? We discussed this in the committee when this thing first came up.

Mr. JACKSON. Ninety-eight or ninety-nine percent tax which had to be realized in cash, would undoubtedly exceed the amount that could be realized from many estates.

Senator KING. Would not a 75-percent tax?

Senator GERRY. Seventy-five percent would, too.

Mr. JACKSON. Seventy-five becomes more debatable. That is all I can say; it is a matter of judgment.

Senator KING. Proceed.

Mr. JACKSON. However, I may say that the actual experience of the Bureau in reference to this thing does not indicate that it is so difficult, as I would assume from my experience outside of the Bureau. I was surprised at these figures, which I will give you.

Of course, the adequacy of these assets, referring to the 55 percent of securities and the 19 percent of real estate—to meet tax claims in any individual case would be influenced greatly by the ratio of debts, pledges, and liens existing. We find, however, that debts, unpaid mortgages, and so forth, were only 14 percent of total gross estate in 1932 and 17 percent in 1933.

Perhaps the best measure of the actual difficulty which estates now experience is the number of estates which are granted extensions of time for the payment of tax. For the fiscal years 1929 to 1935 the average numbers of estates obtaining extensions has been under 2 percent, and are as follows:

Fiscal year	Returns filed	Extensions granted	Percentage
1929.....	9,719	119	1.22
1930.....	10,308	122	1.18
1931.....	9,816	139	1.42
1932.....	8,183	148	1.81
1933.....	8,504	184	2.16
1934.....	11,210	272	2.43
1935.....	13,133	284	2.16

In 1929 it was 1.22 percent, and that increased so that the greatest number of extensions occurred in 1934, being 2.43 percent, and in 1935 they declined to 2.16 percent.

I have also broken this down to estates of different sizes so that the extensions as they apply to estates of different sizes of net assets is shown.

(The table is as follows:)

Data on extensions of time for payment of Federal estate taxes

Fiscal year ending June 30—	Exten- sions denied	Extensions granted						
		Tax less than \$50,000	\$50,000 to \$100,000	\$100,000 to \$200,000	\$200,000 to \$300,000	\$300,000 to \$400,000	\$400,000 to \$500,000	Over \$500,000
1929.....	95	92	9	8	5	None	1	4
1930.....	123	99	15	2	2	None	1	3
1931.....	56	107	18	6	2	None	2	4
1932.....	55	123	9	5	6	None	1	4
1933.....	51	162	5	6	3	3	None	5
1934.....	89	234	20	12	2	2	None	2
1935.....	123	248	9	11	4	2	2	8

I do not see in a study of the table any very great difference in the ratio. The small estates seem to have as much difficulty as the large ones.

Senator KING. Have you any evidence showing the disposition of some of those estates? That is, whether they were closed out entirely if they were going business concerns?

Mr. JACKSON. No; of course, the records of the Bureau could not have anything that would be particularly enlightening on that, but I have talked with the men who are in charge of the administration, and they are unable to point out any cases such as we read of in the papers where going businesses have been closed because of the effect of the estate tax.

It should be noted, in reading these tables, that the higher rate imposed by the 1932 act became effective for the first time in returns filed in 1933.

Some days ago, as a result of testimony given before the House Ways and Means Committee, wide publicity was given to one estate which, a large part of the press indicated, was an example of the reduction of a \$72,000,000 estate to from two to six million dollars.

The fact is that this gross estate was returned at \$68,000,000 and appraised by the Government at \$75,000,000. Its debts amounted to approximately \$5,000,000. Various other deductions were claimed, including \$1,400,000 of attorneys' fees of which the Bureau would allow only \$400,000. The executor's commissions were \$3,569,000. The net estate, after payment of debts and expenses, was adjusted at \$65,266,000. The total tax paid to all taxing authorities was \$12,398,000, and of that the Federal Government received only \$2,813,021, or substantially less than the executor's fees.

The same estate, whose total tax obligation upon the transfer of \$65,000,000 net was \$12,398,000, had over \$15,000,000 of tax-exempt securities, upon which no income tax had ever been paid.

The National Industrial Conference Board, in a study of inheritance tax proposals, asks:

If a well-to-do business man, with a net estate of \$100,000,000, over and above the exemption of \$50,000 for the estate tax, should desire to leave his estate to an only son, what net amount would the son receive?

Upon certain assumptions it answers that he would receive \$13,157,850, and death taxes of all kinds would take about 87 percent of the estate.

Senator KING. Would that include the State taxes?

Mr. JACKSON. That includes all taxes, including the property taxes as contained in the House measure.

Senator WALSH. This is the assumption of the National Industrial Conference Board?

Mr. JACKSON. Yes.

Senator WALSH. Not your assumption?

Mr. JACKSON. This is the problem that they put up to us.

Upon certain assumptions it answers that he would receive \$13,-157,850, and death taxes of all kinds would take about 87 percent of the estate.

One involuntarily asks if an estate of \$100,000,000 represents that of a "well-to-do business man," what size estate does a man need to be considered really rich?

The example so offered, is oversimplified, and other elements will be present in actual practice that enter into the consideration of the policy of the tax. It is not unusual for a "well-to-do business man" with an estate of \$100,000,000 in fact to follow the simple procedure specified. If the experience of the Bureau of Internal Revenue is to guide, you may safely assume that the son, during the father's lifetime, has had many direct and indirect advantages from his father's surplus of resources. In a great majority of cases, you will find that he has already been given money and property, which represent a fortune as compared to the resources of most men. The father has probably set up trusts for the support of his children and grandchildren. Some of America's richest families have carried the setting up trusts for future generations to the very limit permitted by law and even provide for those yet unborn.

A very recent and tentative study of the tax methods pursued by one large family indicate the existence of 197 separate trusts, resulting in great tax advantages from the split-up of the income to separate tax entities. You will also find that the son has been given shares of stock in some of the leading companies in which his father's estate has been invested; that he has been elected to boards of directors, and probably placed in a position to receive a substantial salary.

He has likely been taken in on profitable transactions and has accumulated a substantial estate of his own. It is a rare thing, in actual practice, that a big estate descends to a person in poverty. Most of the big estates descend to persons already advantaged by wealth far beyond the hopes of the average person. A study of the practice of the owners of large estates in this country will sustain these observations. Therefore, we may safely assume that the \$13,000,000 net inheritance tax is a small part of the real advantage from the accident of being born son of a well-to-do business man.

Of course, even taking the National Industrial Conference Board's naked example, the hundred-million-dollar estate will leave for the heir \$13,000,000. At interest rates of 4 to 5 percent this will produce a regular annual income for the heir ranging from a half million to seven hundred thousand dollars.

Our view of the difficulty of administration of an inheritance tax may easily be too much influenced by the abnormal period we have just passed through. Many hardships partly due to taxes are cited, some of them exaggerated as to the effect of taxes, but many of them serious. Sacrifices due to hurried liquidations have been made and

losses have also been sustained where executors failed to liquidate promptly. Estates that are involved in debt suffer more than those not so handicapped. There are few cases where hardship due to taxes alone can be cited. There are many cases where hardship due to debts alone can be cited. Many estates in the past 5 years would have faced tremendous shrinkage in liquidation if there had been no tax whatever.

If values as existing at the date of death are in danger of being sacrificed in liquidation, it would be practical to allow a deduction from the value at date of death, equal to the amount of loss sustained during administration through the sale in good faith and by arm's length transactions of any assets. This would not present serious administrative difficulties. It would encourage prompt liquidation and the Government would share the loss from any enforced liquidation.

Valuations of estates present a most difficult subject in administration.

When the time comes to consider more fully administrative provisions, consideration should be given to settling valuation questions wherever they arise in tax administration in some manner other than by litigation. The litigation method of determining values is too technical, slow, and uncertain. We have now on trial before the Board of Tax Appeals a case to determine the value of one estate, which has been continuously on trial since last September.

Senator WALSH. Let me call your attention to this sentence:

If values as existing at the date of death are in danger of being sacrificed in liquidation, it would be practical to allow a deduction from the value at the date of death, equal to the amount of loss sustained during administration through the sale in good faith and at arm's length transactions of any assets.

Is there any provision proposed by the Treasury to incorporate this provision in this bill?

Mr. JACKSON. The bill already contains, Senator Walsh, a provision for allowing for shrinkage in the assets.

Senator GERRY. It is only 1 year, is it not, Mr. Jackson?

Mr. JACKSON. Within a year.

Senator WALSH. On what basis is that shrinkage to be?

Mr. JACKSON. That shrinkage would apparently, from the bill, require a revaluation at the end of the year. That presents great difficulties administratively.

I would personally be very glad to see in lieu of that, the allowance of the loss actually sustained. That is consistent with our income tax practice, that you allow loss when it is realized. If you have an estate, and it owns stock appraised at the date of death at \$100,000, and in the course of liquidation it is sold for \$75,000, I think it is no more than fair that that loss be allowed, particularly in getting at an inheritance tax, which is based theoretically on the amount received.

Senator WALSH. In other words, the executor might, acting in good faith, proceed for a year to liquidate the estate, particularly those assets in the estate that have shrunk in value, and to go the Treasury at the end of the year and say, "These are our losses, and we want them allowed in the value of the estate." Is that the principle?

Mr. JACKSON. They would not make their return for a year, so that any losses that they had during the year they could reflect

in their return, but if they actually make sales and actually take a sacrifice——

Senator WALSH (interposing). The value of the assets has to be determined as of the date of death?

Mr. JACKSON. That is right.

Senator WALSH. But during the year, in liquidating certain of the assets, when they made their return at the end of the year, they could point that out and take the deduction?

Mr. JACKSON. That is right. Valuations made at the date of death are arbitrary, no matter who makes them, and if they are later verified during the course of administration by a sale, it seems to me that the sale, which measures what is actually received by the estate, is a fair basis for figuring the tax, particularly where you run into high rates, it may be very well to assess the estate on the hypothetical valuation if the rates are not high. But in this situation if the executor in order to pay this tax, sacrificed assets in sales, I think it would hardly be fair to assess them on a theoretical basis.

Senator GERRY. At the end of 10 years, he might reassess them when he settles up the estate.

Mr. JACKSON. I do not know that I would extend it to 10 years. I think that would be questionable, but I think some reasonable period during which estates usually are administered.

Senator WALSH. You think we might well consider extending the time beyond 1 year?

Mr. JACKSON. I think it might well be considered beyond 1 year.

Senator WALSH. Have the return made at the end of the year as now, and have a supplemental return permitted to be filed at the end of the second or the third year showing what changes have taken place in the value of the assets as first returned.

Mr. JACKSON. As a basis for a refund claim if the tax had been paid, or a credit if not.

Senator BARKLEY. I have not examined this bill caretully. You are speaking now of the value of the estates; a valuation at the date of death. There may be much time between the death of the owner and the distribution of the estate to the heirs. You do not in this bill fix the value of the estate at the time of the death of the owner as the value of the inheritance, do you?

Senator BARKLEY. Suppose that an estate is not distributed for 3 or 4 years. Suppose they take advantage of all of the time they have to pay this estate tax, which is now 5 years, is it?

Senator KING. Eight years, but they have to pay interest.

Senator BARKLEY. There is no final distribution of the estate until the estate tax is paid. What provision is there with respect to the adjustment of the value of the estate when it is actually distributed?

Mr. JACKSON. There is a provision in the act which provides that among the credits the estate is entitled to is the net shrinkage in value of the total beneficial interests of the beneficiary arising solely from the difference in the value of the assets of the decedent's estate on the date of death and the value of such assets 1 year after the decedent's death or date of sale or exchange in the case of assets sold or exchanged during such period, but only to the extent that such shrinkage is not covered by any other deduction under this subsection. That is subsection 7 of section 205.

The difference between that provision and the provision which I have suggested is that this permits a revaluation which, from an administrative point of view, runs us into great difficulty. We have difficulty enough to arrive at one fair valuation. If you have to have two, it becomes a serious problem.

Senator KING. So you take the first valuation as a basis, but if there is any shrinkage realized through sale——

Mr. JACKSON (interrupting). Yes.

Senator KING (continuing). You let that be a deduction. But in the meantime interest is charged. When does the interest commence?

Mr. JACKSON. I do not know that I can tell you that. Mr. Turney says the tax is due in 18 months, and the first 6 months extension can be made without interest, and after that the interest runs—at what rate?

Mr. TERNEY. Three percent for 2 years, and then——

Senator GERRY (interposing). It is 6 percent on the estate tax. That does not run until 18 months after the decedent's death. Then 6 months after that, the inheritance tax runs at the rate of 3 percent more. That makes 9 percent. Then at the end of 5 years the interest rate goes to 12 percent on the entire estate. You testified to that the other day.

Mr. JACKSON. That is too high.

Senator WALSH. Would you prepare an amendment and let us have the Treasury's view of this matter?

Mr. JACKSON. I will be very glad to give you the best judgment we have.

Senator BARKLEY. Where the heir inherits money, it is easy to fix the tax on that, and the tax is payable at the time he receives it and it is distributed to him. But where there is a distribution that comes 5 years after the death of the owner and maybe 8 years, if they have waited that long to pay the tax, there has been no final distribution or valuation of the inheritance until the tax was paid on the estate itself, and it strikes me that any readjustment made within 1 year after the death of the decedent where the actual distribution may not occur for 4 or 5 or 6 years would not necessarily be a fair criterion of the amount of tax that ought to be levied on the inheritance based on the value of it when it is inherited.

Mr. JACKSON. That is quite likely true, Senator Barkley. Of course, the amount received by the heir comes from his books at the figure that it is valued at, and becomes the basis for income tax as to future gains or losses. So that the Government would not be seriously prejudiced by the results of the estate-tax valuation if it is not too high.

Every now and then we find someone who has gotten in very serious difficulty by working the estate tax down pretty low and getting some assets on their hands at a low valuation, and then selling them. I do not think that the valuation, if it resulted in some reduced valuation in the estate tax, would be a serious matter from the revenue viewpoint ultimately, and I think we can well afford to be entirely just in the ascertainment of the value on which these estates are to be taxed if we are going to tax them at high rates.

Senator KING. It is obvious, is it not, Mr. Jackson, that taking the last 2 or 3 years and the present situation as a standard of determining values and difficulties and advantage of the possession

of property, if a man should die now with some involvement of the reason of death, it would mean a considerable—especially if he had real estate or stocks or bonds that had been acquired at high values and there were some obligations due upon them—it would be a considerable diminution in the value of the estate and in the liquidation of it, it would suffer materially in value, would it not?

Mr. JACKSON. That is particularly true in these times, and it is true to some extent in many times.

Senator WALSH. This would not be a good time to die, then?

Senator BARKLEY. No time is a good time to die.

Mr. JACKSON. That might depend on situations that relate to matters that the Treasury would have no information about.

Senator GERRY. Of course, Mr. Jackson's argument does to the point that this tax will force the person who expects to die, if he wants to look after his heirs, to being to disperse the estate now, and that is the phase of the argument, that this will force them to go into the gift tax, so as avoid paying inheritance tax, which I think is a little peculiar argument.

Mr. JACKSON. That is the purpose, as I understand it, in fixing the gift tax rates at three-quarters of the inheritance tax rates to encourage gifts.

Senator KING. Have you anything more to submit on this, because we want to take a recess in a few moments? I mean on this particular branch of the question you are discussing?

Mr. JACKSON. I think the only other matters cover this subject of valuation which I have already discussed in answer to some questions. I am ready to suspend at any time.

Senator KING. Then if it is agreeable to the committee and to you, we will take a recess until tomorrow morning at 10 o'clock, and, Mr. Jackson, we will have you on our hands tomorrow. I say that, of course with a smile, meaning that we are delighted to have you on our hands, and then, following your testimony, we will have a number of witnesses, among them being Hon. William D. McFarlane, Representative in Congress from the State of Texas; Fred H. Claussen, Horicon, Wis., chairman committee on Federal finance, United States Chamber of Commerce; Fred B. Fairchild, professor of economics, Yale University; Roy C. Osgood, Chicago, Ill., representing the First National Bank; William W. Schneider, St. Louis, Mo., representing Monsanto Chemical Co.; Hugh Satterlee, New York City, chairman committee on taxation, Bar Association of the City of New York; E. H. Terhune, New York City, representing the Associated Business Papers, Inc.; and John Benson, New York City, representing the American Association of Advertising Agencies.

The committee will take a recess until tomorrow morning at 10 o'clock.

(Whereupon, at 11:55 a. m., the committee recessed until tomorrow, Wednesday, Aug. 7, 1935, at 10 a. m.)

REVENUE ACT OF 1935

WEDNESDAY, AUGUST 7, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in the Finance Committee room, Senate Office Building, Senator Walter F. George presiding.

Present: Senators George (presiding), King, Walsh, Gore, Costigan, Byrd, Lonergan, Gerry, Guffey, La Follette, and Capper.

Senator GEORGE. The hour having arrived, the committee will please come to order. We might as well resume the hearing. Mr. Jackson.

STATEMENT OF ROBERT H. JACKSON—Resumed

Mr. JACKSON. Senator George, the second of the studies, prepared under the direction of the Secretary of the Treasury, Mr. Morgenthau, relates to graduated corporation income taxes, intercorporate dividend taxes, as proposed in the President's message, and some facts relating to the operation of the excess-profits tax, as it is now on the statute books.

The President's tax message of June 29, 1935, says:

I, therefore, recommend the substitution of a corporation income tax graduated according to the size of corporation income in place of the present uniform corporation income tax of 13¼ percent. The rate for smaller corporations might well be reduced to 10¼ percent, and the rates graduated upward to a rate of 16¼ percent on net income in the case of the largest corporations, with such classifications of business enterprises as the public interest may suggest to the Congress.

This recommendation involves decreases as well as increases and a table of rates roughly complying with this recommendation and estimated to yield \$102,200,000 in revenue is taken for the purpose of illustration as follows:

Graduated tax on corporation income—estimated increase in revenue \$102.2 millions

Income bracket (in thousands of dollars)	Rate	Total tax ¹ (in dollars)	Percentage of tax to total taxable income ¹
	<i>Percent</i>		
Up to 2.....	10	200	10
2 to 15.....	13½	1,955	13.03
15 to 40.....	14	5,455	13.64
40 to 100.....	15	14,455	14.46
100 to 300.....	16	46,455	15.49
300 to 1,000.....	17	165,455	16.55
Over 1,000.....	17½		

¹ Computed on upper limit of brackets.

Over \$1,000,000 of taxable income, 17½ percent.

Upon the basis of our estimate of corporation incomes for the calendar year 1935, 182,000 corporations, or 95 percent of all of those expected to report net incomes for this year, would pay a smaller tax under such a schedule than under the flat rate now in effect.

It is apparent, therefore, that the proposal of the President in addition to producing additional revenue involves a redistribution of the corporation tax burden by which 95 percent of all corporations obtain some tax relief, and about 5 percent, consisting of the largest corporations, would sustain an additional burden.

Such a shifting of the burden would produce desirable consequences from many standpoints.

A weakness of our income-tax structure revealed by the depression is the violent fluctuation of Government revenues resulting therefrom. It is apparent that if we can combine a tax based on ability to pay with increased reliance for revenues upon that class of corporations whose income is most stable, and decrease our reliance for revenues upon those corporations whose income shows the greatest fluctuation, we move in the direction of stabilizing the revenues and evening our fluctuations.

It, therefore, becomes of importance to know whether there is a difference in the stability of the income between large and small corporations. The information is not adequate to give conclusive finality. Our latest complete figures are for 1932 and do not therefore cover the whole depression cycle. So far as available the information seems to receive a pretty generally agreed interpretation.

The National Industrial Conference Board, in a study dated July 19, 1935, which recommends against this tax, nevertheless advances the following significant conclusions [reading]:

The most significant conclusion suggested by this table is that the larger corporations showed more stability than the small corporations under the adverse conditions of 1931 and 1932. In the income group the small corporations reported the largest profits ratios, while in the no-income or deficit group they sustained the heaviest losses. The variation in the ratios among the size classes was considerably larger for the no-income group than for the income group, hence the relatively larger losses for the smaller corporations when both groups are combined.

The Board supports the conclusion with the figures taken from the Treasury Department's Statistics of Income. The Treasury Statistics of Income for 1932, show that the statutory net deficit of corporations of less than \$50,000 of assets constituted 33 percent of their net worth, and that the percentage deficit was progressively smaller for each succeeding group of larger corporations.

Then I have here a table showing the percent of statutory net income or deficit to net worth of corporations classified by size of total assets, for 1932, showing a range downward from corporations under \$50,000 at 33 percent to corporations of \$50,000,000 and over, 1.1 percent and, for the total, 3.9 percent.

The National Industrial Conference Board also made a study of 1931 corporation income-tax returns and arrived at substantially similar conclusions. In a bulletin dated March 20, 1934, the Board shows for manufacturing corporations alone not only that—

The statutory net deficit in operations of 1931 was relatively greatest in the smallest corporations—

but that—

the proportionate deficit to gross sales is seen to have become gradually smaller, except in one class, as assets increased in size, and among the largest corporations, the deficit disappeared altogether, having been replaced by a relatively small net income.

The Board further found, in considering manufacturing corporations alone by asset clauses [reading]:

When the results of manufacturing operations are related to the capital stock and surplus, the ratio of deficit to the size of assets is very striking. In the smallest corporations, the deficit was 25.6 percent of the book value and exceeded 10 percent in the next class above this. The proportion dwindled from this point to 0.4 percent in corporations with assets of \$10,000,000 to \$50,000,000, while the largest corporations showed profit of 2.1 percent.

Two tables summarizing these points follow.

I do not think it is necessary to read the tables if they may be made a part of the record.

Senator KING. That may be done.

(The tables referred to are as follows:)

Manufacturing corporations by asset classes, gross sales, and net deficit, 1931

Asset classes (thousand dollars)	Amounts in million dollars		
	Gross sales	Statutory net deficit	
		Amount	Percent of gross sales
Under 50.....	1,437	105	7.3
50 to 100.....	1,348	68	5.0
100 to 250.....	2,625	125	4.8
250 to 500.....	2,474	106	4.3
500 to 1,000.....	2,717	98	3.6
1,000 to 5,000.....	6,256	240	3.8
5,000 to 10,000.....	2,529	55	2.2
10,000 to 50,000.....	6,505	116	1.8
50,000 and over.....	15,541	(1)	(1)
Total.....	41,433	770	1.9

¹ Corporations in this group made a net income of 141 million dollars which was 0.9 percent of the gross sales.

Manufacturing corporations by asset classes, capital, and deficits, 1931

Asset classes (thousands of dollars)	Amount in millions of dollars		
	Capital stock and surplus	Deficit	
		Amount	Percent of capital stock and surplus
Under 50.....	407	104	25.6
50 to 100.....	582	67	11.5
100 to 250.....	1,494	122	8.2
250 to 500.....	1,774	101	5.7
500 to 1,000.....	2,334	91	3.9
1,000 to 5,000.....	6,785	209	3.1
5,000 to 10,000.....	3,283	38	1.1
10,000 to 50,000.....	8,888	36	.4
50,000 and over.....	22,092	(1)	(1)
Total.....	47,640	308	.6

¹ Corporations of this group had net profits amounting to 460 million dollars or 2.1 percent of their capital stock and surplus.

Mr. JACKSON. The National Bureau of Economic Research on April 18, 1934, called attention to the fact that, when corporations are grouped according to the value of their assets, no group earned an aggregate net profit in 1931 except the group whose assets exceeded \$50,000,000. These concerns (not including subsidiaries) numbered only 632 out of the 381,000 corporations included in the study. But, with their subsidiaries, they owned more than 50 percent of the total assets reported by the 381,000 corporations, \$155,000,000,000 out of the total of \$296,000,000,000. Further the Bureau called attention to the fact that there was an impressive relationship between size of corporations and relatively smallness of losses—the group of smallest corporations experiencing the greatest percentage of deficit. This study is summarized in a table which I think it is unnecessary to read if it may be added to the record.

Senator KING. It will be incorporated in the record.
(The table referred to is as follows:)

Earnings of Corporations in the United States ¹ 1931, classified by size

[Source: Recent Corporate Profits in the United States, by Solomon Fabricant (Bull. No. 50, National Bureau of Economic Research, Apr. 18, 1934)]

Size (total net assets in thousands of dollars)	Number of reporting corporations	Aggregate net profits after tax (in millions of dollars)	Aggregate net profits after tax, relative to total stock equity (percent)
Under 50.....	182,447	-415	-21.7
50 to 100.....	61,144	-218	-9.1
100 to 250.....	63,428	-353	-6.5
250 to 500.....	31,052	-268	-4.6
500 to 1,000.....	19,335	-271	-3.9
1,000 to 5,000.....	18,345	-591	-3.0
5,000 to 10,000.....	2,588	-166	-1.8
10,000 to 50,000.....	2,117	-104	-.5
50,000 and over.....	632	1,507	+2.2

¹ Excluding corporations not reporting balance sheets.

Mr. JACKSON. Similarly, Prof. W. L. Crum of Harvard University, in a study entitled "The Effect of Size on Corporate Earnings and Condition", published in June 1934, by the Bureau of Business Research of the Graduate School of Business Administration of Harvard University, concluded, on the basis of 1931 returns—quoting Professor Crum [reading]:

The most striking finding of the above analysis, with reference to corporate earning power, is the fairly general tendency for larger corporations to have a higher average return on their gross business than smaller corporations.

* * * * *

Although this tendency does not appear without exception in all divisions and groups, and is accompanied with some irregularities even in various groups where it does appear, it is so common in the cases examined that there is ample reason for regarding it as a roughly general rule.

Professor Crum also declared [reading]:

The second finding of chief significance is that, in general, large corporations had a smaller rate of loss on their net worth in 1931 than did smaller corporations.

Another finding by Professor Crum is significant [reading]:

Among the other subordinate ratios, one of the most significant is the ratio of current assets to current liabilities. Examination of this ratio shows that the current position of larger companies was emphatically better than that of smaller companies for most lines of industry in 1931.

The Treasury, in the light of information now available, is of the opinion that the graduated income tax proposed by the President, which will base revenue yield more upon larger and less upon smaller corporations, would produce a more reliable, predictable and steady flow of revenue to the Government than the present flat rate of tax for all.

It also believes that such larger corporations are, by reason of their more stable revenues, better able to anticipate and bear the burdens than smaller corporations whose incomes tend to fluctuate more erratically.

However, even though it is desirable to tax big corporations at a higher rate than little corporations, from a revenue viewpoint, the proposal would need examination as to its secondary consequences and as to the underlying economic conditions on which the proposal would operate.

Concentration of corporate assets in this country today can be determined with a fair degree of accuracy from Treasury statistics. Only those corporations which failed to submit income tax returns or failed to include balance sheets with their returns are omitted from our studies, and they are too insignificant to affect the result substantially. In 1932, the number submitting balance sheets was 392,021, and they reported total assets owned of \$280,085,000,000.

The degree of concentration of assets revealed is startling. Over 53 percent of the value of all assets owned by corporations in this country was owned by 618 corporations, constituting only 0.2 of 1 percent of the number of corporations. At the lower extreme the percentage of assets owned is equally significant. Sixty-seven and six-tenths percent of all American corporations held only 2.9 percent of the aggregate corporate assets. I have said that the percentage of corporations whose tax would be increased, by application of the President's message, would be only 5 percent of the total number reporting. We find that 5 percent of the corporations owned 85 percent of all the wealth owned by corporations in 1932. The 5 percent owning the 85 percent of the corporate wealth and the 5 percent whose taxes would be increased are not necessarily identical, but most of the corporations in one class will also be found in the other. A table showing the details of the distribution of assets among corporations of various sizes follows, and I will not include it in the reading if it may be incorporated in the record.

Senator KING. It may be included.

(The table referred to is as follows:)

All corporations filing balance sheets with returns in 1932, distributed by amount of total assets

Assets class (thousands of dollars)	Number of returns			Total assets (millions of dollars)		
	Number in class	Number cumulated	Percent cumulated	Amount in class	Amount cumulated	Percent cumulated
Under 50.....	206,477	392,021	100.0	3,870	280,083	100.0
50 to 100.....	58,320	185,544	47.3	4,153	276,213	98.6
100 to 250.....	59,500	127,224	32.4	9,414	272,060	97.1
250 to 500.....	28,422	67,724	17.3	9,988	262,646	93.8
500 to 1,000.....	17,590	39,302	10.0	12,289	252,658	90.2
1,000 to 5,000.....	16,705	21,712	5.5	34,432	240,369	85.8
5,000 to 10,000.....	2,442	5,007	1.3	16,857	205,937	73.5
10,000 to 50,000.....	1,917	2,565	.7	39,839	189,080	67.5
50,000 and over.....	618	618	.2	149,241	149,241	53.3

Mr. JACKSON. We turn now to a study of degree of concentration of net income reported by corporations for the year 1932. For this purpose, corporations which failed to have net profits are dropped out of the calculations and we have left, as the basis for the study, 73,291 corporations, which reported a net profit and filed balance sheets with their returns.

Senator KING. Seventy-three thousand out of five hundred—

Mr. JACKSON. Seventy-three thousand out of 392,000.

Senator KING. Let me see if I understand that. More than 300,000 filed returns showing profits?

Mr. JACKSON. No; more than 300,000 were required to, and did, file returns; 392,000 filed returns and submitted balance sheets. Of that number, 73,291 reported a net profit.

Senator KING. A greater number of those reported a profit of less than \$15,000?

Mr. JACKSON. The table at page 12 of the statement shows the spread. The table breaks it down by asset classes.

Of all net incomes enjoyed by corporations during 1932, 50.4 percent went to 201 corporations which represented only 0.3 of 1 percent of the number of corporations having some net income. On the other hand, at the other extreme, 45 percent of such corporations had less than 2 percent of the total income. The details of corporate income by asset classes of corporations is set forth in the following table:

I will not go into details with the table if it may be made a part of the record.

Senator KING. That may be incorporated in the record.

(The table referred to is as follows:)

*All corporations reporting net income in 1932 and filing balance sheets with returns
amount of compiled net profit distributed by total assets classes*

Assets class (thousands of dollars)	Number of returns			Compiled net profits (millions of dollars)		
	Number in class	Number cumulated	Percent cumulated	Amount in class	Amount cumulated	Percent cumulated
Under 50.....	33, 512	73, 291	100. 0	44	2, 697	100. 0
50 to 100.....	11, 726	39, 779	54. 3	40	2, 653	98. 4
100 to 250.....	12, 610	28, 053	38. 3	89	2, 613	96. 9
250 to 500.....	6, 344	15, 443	21. 1	101	2, 524	93. 6
500 to 1,000.....	3, 963	9, 099	12. 4	122	2, 423	89. 8
1,000 to 5,000.....	3, 775	5, 136	7. 0	315	2, 301	85. 3
5,000 to 10,000.....	625	1, 361	1. 9	188	1, 986	73. 6
10,000 to 50,000.....	535	736	1. 0	440	1, 798	66. 7
50,000 and over.....	201	201	. 3	1, 358	1, 358	50. 4

Senator KING. I suppose you have no figures showing the stockholders of that limited number—0.3 percent?

Mr. JACKSON. I am going to give you all the figures we have. Unfortunately we get no statistics as to those persons who do not file returns and under \$5,000 of net income, the statistics of the Bureau are not so kept that we can determine the number of persons who received dividends. We can determine the amount of dividends received, but the statistics under \$5,000 are not broken down sufficiently to enable us to determine the question which you asked yesterday, but I am having the best information we have prepared and will submit it to you.

If we eliminate financial institutions, railroads and public utilities, and other classes of business, and consider only manufacturing enterprises we find a similar degree of concentration. Of the total wealth owned by corporations engaged in manufacturing, 64.4 percent was concentrated in the hands of eight-tenths of 1 percent of the number of corporations classified in that field. Manufacturing corporations with assets of 10 millions and over constituted only 1.2 percent of the total number of manufacturing corporations reporting net income, but this small group accounted for 63.3 percent of the aggregate compiled net profits of all manufacturing enterprises as set forth in two tables which follow.

Again, I think those tables need not be read if they can go into the record.

Senator KING. That may be done.

(The tables referred to are as follows:)

All manufacturing corporations filing balance sheets with returns in 1932, distributed by amount of total assets

Assets class	Number of returns			Total assets		
	Number in class	Number cumulated	Percent cumulated	Amount in class	Amount cumulated	Percent cumulated
Under \$50,000.....	40,901	82,113	100.0	\$785,000,000	\$59,023,000,000	100.0
\$50,000 to \$100,000.....	12,539	41,212	50.2	897,000,000	58,238,000,000	98.7
\$100,000 to \$250,000.....	13,021	28,673	34.9	2,065,000,000	57,341,000,000	97.2
\$250,000 to \$500,000.....	6,506	15,652	19.1	2,290,000,000	55,276,000,000	93.7
\$500,000 to \$1,000,000.....	4,043	9,146	11.1	2,797,000,000	52,986,000,000	89.8
\$1,000,000 to \$5,000,000.....	3,887	5,103	6.2	8,090,000,000	50,189,000,000	85.0
\$5,000,000 to \$10,000,000.....	587	1,216	1.5	4,096,000,000	42,099,000,000	71.3
\$10,000,000 to \$50,000,000.....	512	629	.8	10,708,000,000	38,003,000,000	64.4
\$50,000,000 and over.....	117	117	.1	27,295,000,000	27,295,000,000	46.2

All manufacturing corporations reporting net income in 1932 and filing balance sheets with returns, amount of compiled net profit distributed by total assets classes

Assets class	Number of returns			Compiled net projects		
	Number in class	Number cumulated	Percent cumulated	Amount in class	Amount cumulated	Percent cumulated
Under \$50,000.....	5,394	14,276	100.0	\$8,000,000	\$888,000,000	100.0
\$50,000 to \$100,000.....	2,354	8,882	62.2	10,000,000	880,000,000	99.1
\$100,000 to \$250,000.....	2,692	6,528	45.7	26,000,000	870,000,000	98.0
\$250,000 to \$500,000.....	1,547	3,836	26.9	34,000,000	844,000,000	95.0
\$500,000 to \$1,000,000.....	1,010	2,289	16.0	45,000,000	810,000,000	91.2
\$1,000,000 to \$5,000,000.....	939	1,279	9.0	124,000,000	765,000,000	86.1
\$5,000,000 to \$10,000,000.....	163	340	2.4	79,000,000	641,000,000	72.2
\$10,000 to \$50,000,000.....	131	177	1.2	163,000,000	562,000,000	63.3
\$50,000,000 and over.....	46	46	.3	399,000,000	399,000,000	44.9

Mr. JACKSON. We find no evidence that a limit to the continued increase in corporate size has yet been reached, or that any real obstacle, economic or legal, to the continued concentration of corporate wealth has yet been created. By comparison between 1932 and 1926, we find that there was an increase in the concentration of corporate income. In 1926, 1.7 percent of the total number of corporations reporting net income accounted for 69.8 percent of the

total of all corporations reporting net income. In 1932 it took only 1.1 percent of the total number of corporations reporting net income to account for 72.6 percent of the aggregate net income reported that year. The 2 years are not fully comparable and the figures, therefore, may reflect an increasing degree of concentration or they may simply be another evidence of the greater fluctuation in income of the smaller income group of corporations.

No condition is so favorable to corporate growth as profits. Profits both provide and attract capital. We may take the distribution of profits as a fair indication of prospects for growth. On that basis concentration and more rapid growth of the big companies in comparison with other companies would appear to be a probable continuing process of our economic life. There is substantial evidence that the depression, because of the greater stability of the larger units, has hastened the concentration of corporation-owned wealth, at least in some industries, and especially in finance.

Senator KING. What do you mean by "finance"? Do you mean banks?

Mr. JACKSON. Banks, yes.

Senator KING. Banks and insurance companies?

Mr. JACKSON. Yes, banks and insurance companies.

Senator KING. And railroads?

Mr. JACKSON. I do not think the railroads would show any similar degree of concentration due to the depression, at least, but I will illustrate the statement by this example:

On December 31, 1929, one of the largest industrial cities in the United States had 72 banks, 8 of which were controlled by the dominant banking interests of that community, and 64 of which were controlled by other interests.

As of December 31, 1933, the 8 banks owned by the dominant group had all survived, whereas the 64 competitors had been reduced, through closings and mergers, to 33 and of those 20 corresponded or cleared through the dominant banks.

During that period the percentage of capital and surplus reported by the dominant group of banks had increased 31 percent, while the percentage reported by their competitors within the city had decreased 38 percent.

Deposits of the dominant banks increased 63 percent, and those of competing banks decreased 45 percent.

In the trade area outside of the same city on December 31, 1929, 19 banks in 17 towns dominated by the same banking interests had 30 banks as competitors. As of December 31, 1933, the dominant banks were all in business and the number of competing banks had decreased to 13 and the proportion of bank capital and deposits under the dominant group had increased accordingly.

The social implications of these facts will be read differently according to the temperament, viewpoint, and perhaps the interests of different observers. That such facts do have an important significance in weighing the merit of the secondary effects of the President's recommendations seems obvious, and from the Treasury's viewpoint they point to a source of revenue to be drawn upon in accordance with ability to pay.

The ability to pay is, in our view, based in large part upon advantages which larger corporations have over smaller ones, so that in-

creased levies upon the former would not only be based upon the theory of ability to pay, but would be based upon benefits received. While it is probably debatable, whether size has not often exceeded the requirements of efficient operation, and whether in fact it has not sometimes been accomplished at the expense of efficiency, there can be little doubt that the greater stability, on the whole, of large corporations is attributable to their many advantages over their smaller competitors; and these advantages are reasons why size provides a useful measure of ability to contribute to the cost of government. Some of the more obvious advantages are—

(1) As buyers of commodities and services, the large volume of their purchases gives the larger corporations a bargaining power that often results in price concessions which smaller concerns do not share.

(2) Through widely distributed branch plants and warehouses they are able to effect important savings in transportation costs and to sell in a Nation-wide market.

(3) Their large resources enable them to buy up important patents, often to pool these patents with those obtained by other large enterprises, and to carry on research programs, the fruits of which, while of public as well as private benefit, accentuate their competitive advantages over their smaller rivals.

(4) In many cases large concerns have become of such dominating size that they are able to control the markets for their products, enabling them to maintain prices that protect their profit margins.

(5) Large corporations possess distinct advantages over their smaller competitors in the facility and cost of financing, for they are able to tap the large reservoirs of capital that are made available through the organized financial markets.

The Treasury has studied the effect of a graduated corporation income tax upon the common-share earnings of selected industrial corporations. It is difficult to learn the exact practical effect for the incomes reported to stockholders. This is because corporations, for income-tax purposes, do not include dividends received from non-consolidated corporations nor do they include tax-exempt interest. Often also, they take for income-tax purposes depreciation and depletion deductions greater than these made in reports to stockholders. Therefore, earnings available per common share, according to the income-tax records, rarely agree with the same information from published reports.

I want to make that warning clear, that in taking the published reports of corporations sent to stockholder as a basis for determining what their actual tax will be, considerable allowance has to be made. I can cite you an example, which is a very exaggerated one, of course, but it illustrates the point.

One corporation has reported from 1922 to 1933, to its stockholders, earnings of over \$18,000,000. It has reported to the Government net taxable earnings of just over a million dollars. It has paid, in dividends to the stockholders, about \$5,000,000 and it has paid to the Government, in taxes during that period, a trifle over \$100,000. Only three times in its history has it paid taxes.

The stockholders of that corporation, if they took the tax law and applied it to the published reports, would get a picture of this tax bill's effect upon them that is wholly unwarranted. A net taxable income is a decidedly different thing than the income reports to stockholders by many of our corporations.

Senator GEORGE. How could there be such a great disparity unless there were charged off for obsolescence or depletion or other allowable charges, enormous sums?

Mr. JACKSON. They are allowable sums in the main.

Senator GEORGE. Tax exempts?

Mr. JACKSON. Tax exempts account for a large part and corporation-owned stocks, because we must bear in mind that the tax-exempt privilege is applied on dividends received by corporations just as it is on Government bonds; therefore, corporations which have large holdings of corporate stock and large holdings of tax-exempt bonds show a very wide difference between net taxable income and income which they are able to report to stockholders.

Senator KING. In the example which you have given, is there any contention that an improper return was made to the Government?

Mr. JACKSON. Yes; I do not think it was correct, but I do not think I can do anything about it. The practice has grown up apparently sanctioned by a long history of administrative practice, at least, of allocating against tax-exempt income all of the expenses of an institution so their net income is nontaxable. I think it is a practice that is not warranted.

Senator GEORGE. Did we not try, in the last act, to apportion those expenses?

Mr. JACKSON. I think an effort was made, but I do not think it has been accomplished.

Senator GEORGE. Probably a hasty effort and probably not very satisfactory.

Mr. JACKSON. But I do not say that the return is not based on justifiable administrative practice. However, I do not think it is a proper application of the principle of tax exemption.

Senator KING. At any rate the institution to which you just referred was not violating the law or the practice of the department in the return which it made?

Mr. JACKSON. So far as that is concerned, I would say no.

Senator KING. You are not making any argument, are you, Mr. Jackson, against individuals or corporations that purchase tax-exempt securities, in view of the fact the Government is issuing so many billions of dollars of tax-exempt securities?

Mr. JACKSON. Certainly not. If the Government invites it and lays down the terms, it cannot criticize citizens who take advantage of it.

Senator KING. The States, counties, and other sovereignties have a right to issue tax-exempt securities and sell them to the people and the people have the right to purchase them.

Mr. JACKSON. I do not have any criticism of those who buy tax-exempt securities, but I do want to make clear the fact that you cannot have an equitable tax system with those securities in the picture.

Senator CAPPER. It is about time, is it not, that we should shut off the enormous offerings of tax-exempt securities?

Mr. JACKSON. I think it is time a constitutional amendment prohibiting further issuing of tax-exempt securities is enacted.

Senator KING. There is a great deal involved in the problem, however, because sovereign cities, for instance, are not willing to

permit the Federal Government to impose upon their issues such taxes as it may see fit, because there may come crises under which the Federal Government might impose heavy taxes upon securities issued by States, cities, et cetera, which would practically prevent them from issuing securities and thus impair their solvency and impair their sovereignty. However, we will not go into that.

Mr. JACKSON. That, I should think, is a fairly remote prospect, although I admit it is conceivable.

Senator KING. It is conceivable if you issued debentures, notes, and bonds by the Federal Government, the States or counties that are tax exempt, they will sell for more in the market and command a higher rate of interest?

Mr. JACKSON. I think that will follow, of course, to some degree.

Senator KING. It will follow to a large degree, will it not?

Mr. JACKSON. I do not think you can say as to what extent, because, as the situation now stands, while tax exemptions are desirable investments for some, they are less desirable for those in the low income-tax brackets than they would be otherwise, relatively. I do not think it is possible to predict with much accuracy the effect it might have.

Senator KING. Well, I can guess that myself.

Mr. JACKSON. Certainly you can.

Senator KING. Proceed.

Mr. JACKSON. The effect upon common-share earnings of the graduated tax is not subject to any fixed rule but would depend upon the capital structure of the particular corporation. All earnings available for preferred as well as for common stock are subject to tax, and the tax would usually be paid by the common stock alone, since the preferred stocks are normally entitled to a fixed return, and the cost to common stockholders would therefore be greater in cases where preferred stock is outstanding.

Also in years of low earnings the amount of the tax per share would be lower, and when no taxable earnings were reported no tax at all would be paid, of course.

We have taken to illustrate the effect of this tax, the relatively high income year of 1930, and the common-stock earnings of five outstanding American corporations. It must be remembered that these examples are merely illustrative and do not provide an accurate measure for all companies, nor even for these companies in any other year.

The effect is shown in the table at page 23 and relates to the year 1930, in which their earnings were relatively high. That high year is taken rather than the years later, when earnings would be much less, because it seems fair, in considering this, to show the effect in the year when there were something like normal operations.

Corporation A would be affected 41 cents a share.

Corporation B would be affected 3 cents a share.

Corporation C would be affected 37 cents a share.

Corporation D would be affected 6 cents a share.

And corporation E would be affected 11 cents a share.

That is assuming that their earnings returned to the high figure of 1930.

(The table showing the figures in detail is as follows:)

Effect of graduated corporation income tax upon earnings applicable to common stock for selected industrial corporations

Corporation	1930 reported earnings per share, common	1930 earnings adjusted for 1934 tax rate	1930 earnings adjusted for graduated tax ¹	Decline due to graduated tax	
				Amount	Percent
Corporation A-----	\$9.12	\$8.93	\$8.52	\$0.41	4.6
Corporation B-----	1.65	1.63	1.60	.03	1.8
Corporation C-----	8.08	7.91	7.54	.37	4.7
Corporation D-----	3.12	3.09	3.03	.06	1.9
Corporation E-----	4.46	4.41	4.30	.11	2.5

¹ Using rates in table on page 1 hereof, estimated to yield 102.2 millions of dollars additional revenue.

Sources: Moody's Industrials for number of common shares and published earnings per share; Bureau of Internal Revenue for corporation income tax liability.

Mr. JACKSON. Treasury statistics show sources of income, such as dividends and show the importance, relative to total income, of the various sources. The largest total amount of dividends reported as being received by any income class, according to the preliminary report for 1933, is that received by those under \$5,000 of net income, but the relative importance of dividends to total income is least in this class, and the relative importance of dividend income is upon an ascending scale as we climb the income brackets. Thus to those under \$5,000 of income dividends on the average contribute but 5.07 percent of their total, while 50 percent of the total net incomes over \$1,000,000 is derived from dividends. A table, showing the relative importance of dividends and wages and salaries in various income groups is as follows, and I will ask to be permitted to incorporate that in the record.

Senator GEORGE. That will be incorporated.

(The table referred to is as follows:)

Relative importance of dividends to various income classes 1933 preliminary report, statistics of income

Net income classes	Total net income	Dividends on stock of domestic corporations	Dividends—percent of income	Wages and salaries	Wages and salaries, percent of income
Under \$5,000-----	\$8,125,000,000	\$412,000,000	5.07	\$5,407,000,000	66.55
\$5,000 to \$10,000-----	1,854,420,000	220,044,000	11.87	937,923,392	50.58
\$10,000 to \$150,000-----	158,571,204	64,530,595	40.70	25,269,379	15.94
\$50,000 to \$1,000,000-----	72,586,000	43,345,000	59.72	2,326,817	3.21
Over \$1,000,000-----	99,015,000	50,283,717	50.78	2,761,338	2.79

Mr. JACKSON. But it is noticeable that while those under \$5,000 received 66.55 percent of their incomes from wages and salaries and only 5 percent from dividends, those of over a million received only 2.79 of their income from wages and salaries, and 50.78 from dividends.

Now, the statement has been made here that there were over 9,000,000 stockholders in American industry. I have tried to verify that and find no information from which the exact number or even an approximate number can be determined. It is very apparent, how-

ever, that there cannot be 9,000,000 security holders in American industry of any substantial amount, if there are only 1,700,000 income taxpayers.

Only 16 percent of the dividends paid are unaccounted for in the income reporting classes and it is inconceivable that, out of 9,000,000, less than 2,000,000 report, but the 2,000,000 reported received 85 percent of the dividends paid. It just does not add up right. There are enormous duplications, as you know. The same man owns stock in many corporations. Many times the individual, particularly if it is a nondividend paying stock, carries his stock in street names and names other than his own. The number of duplications is plainly not accounted for in the statistics which have been cited to this committee.

Going now from the general background for all of the tax measures, to the specific proposals of the President:

One of the very important recommendations made by the President is a tax on intercorporate dividends.

The simple method of accomplishing this is to withdraw in part, the present privilege of tax exemption. Dividends received by a corporation are now wholly free of the corporation income tax unless received from a foreign corporation, or one not itself liable to the corporation income tax.

If this tax-free privilege were limited to 85 percent of the income received from dividends, so that only 15 percent of dividend income were taxable at corporation rates, the effect, under the present flat 13¾ percent corporation income-tax rate would be a tax on intercorporate dividends at the rate of 2.0625 percent.

Assuming however, the enactment of the graduated corporation income tax, the effective rate of tax on intercorporate dividends would depend upon the income-tax bracket of the receiving corporation, and using the rates set forth for illustrative purposes earlier in this discussion, it would vary from 1½ percent for dividends received by corporations falling into the lowest bracket to 2.625 percent for dividends received by corporations in the highest bracket.

If the same segment of income should pass through a number of corporations in its course from the original earning corporation to the final receiving individual, the intercorporate dividend tax would be compounded for all corporations save one through which the dividend passed. In the case of some of the complex holding-company structures the total might mount up to 8 or 10 percent. The tax would mount in proportion to the pyramiding of corporate structures of the holding-company system.

It is not possible, from data available in the Bureau of Internal Revenue, to present comprehensive and accurate examples of the effects upon common share earnings of such reduction from 100 to 85 percent in the present exemption from corporation income tax allowed to dividends received by corporations. The reason is that the forms in use by the Bureau for corporation returns were designed primarily to exclude dividend receipts by corporations from taxable income, rather than to set forth in detail the character and amount of such receipts.

On the basis of the available data, however, it is strongly indicated that the proposed reduction in the exemption would result in only a slight increase in the taxes paid per share of common stock in typical

large corporations. For example: In the case of one large public-utility holding company which has numerous subsidiaries which, in turn, have their own subsidiaries, it is estimated by the Bureau that, even on the basis of the liberal dividends paid to the company in 1930, the effect of the proposed reduction in exemption would have been only 12 cents per share of the common stock. In the case of a large industrial corporation with many subsidiaries, the common share earnings in 1930, it is estimated, would have been affected by only 5 cents per share.

Dividends have long been a favored source of income to both corporations and individuals under our income-tax law. On the theory that dividends were taxed when earned by the original corporation they have been made free of the individual normal tax. And on the theory that they would be taxed when distributed to the individual, corporate earnings have not been made subject to such high rates as are found in individual surtax brackets.

The treatment of the two taxes presume that the corporate earnings will reach their ultimate owners promptly. So long as corporate earnings are retained by the earning corporation, or are passed about by corporations which receive them free of tax, the Government's tax on the earnings is far from effective. The basis upon which corporate dividends are given their present treatment as between individual and corporation taxes is removed and revenues are postponed when intermediate corporations are interposed between the ultimate individual stockholder and the earning corporation.

Senator KING. The President's recommendation was based largely, was it not, upon the theory that it was necessary in order to prevent evasion?

Mr. JACKSON. That is true. The message refers particularly to the necessity of enacting this tax law in order to avoid evasions by breaking up in form but not in fact, so as to obtain the advantages of a smaller bracket rate.

Senator KING. I suppose you are aware that efforts have been made by a number of Senators, including myself, in former revenue bills to tax large reserves which perhaps were conceived to be unnecessary. Has the Treasury studied that question, whether or not an unnecessary, unusual, and improper reserve might be taxed?

Mr. JACKSON. Yes, Senator King, we have studied it a great deal. We have studied the acts that are now upon the books with a view to trying to enforce them, and I think it is no secret that they are extremely difficult of enforcement.

In the first place, they are based upon the unreasonableness of the reserve for the requirements of the business.

Senator KING. Of course that is a question that is susceptible of difference of opinion.

Mr. JACKSON. It is a question of fact, and upon that question of fact the corporate management has much the advantage of the Government when it comes to determining what is reasonable reserve.

Senator KING. I suppose it has been recognized that these reserves have been the means of enabling many of the corporations to weather storms and at the same time give employment to a large number of people by continuing the activities of their concern?

Mr. JACKSON. Of course the corporations with reserves are in a better position to face a depression providing the reserves are in.

liquid form. If the reserves were like the original capital, invested in brick and mortar, of course, it was not in shape to do that.

Of course, the use of the word "reserves" to cover book reserves invested in plants and also to cover book reserves which may be invested in liquid form, leads to erroneous conclusions.

Senator KING. Very well, proceed. I will not divert you from your presentation.

Mr. JACKSON. It is a rather difficult thing to enforce any tax statute which requires the Bureau to substitute its judgment of what is reasonable or proper for the judgment of the corporate management and it is also difficult to enforce any tax statute which depends upon motive.

When you say that a corporation is formed or availed of for the purpose of avoiding the surtax, you immediately run into the question as to what the real purpose was and, of course, the taxpayer knows, and all you have on the Government's side are certain indications and the more skillfully the indications have been arranged, the less chance the Government has to enforce the tax. Those sections, with which we are fully in sympathy and are trying to enforce, are difficult to enforce, and I would not want to say very successfully. I am sorry to say that.

The secondary effects of an intercorporate dividend tax are extremely important. In tax enforcement, observations of social effects are only incidental and by no means comprehensive. It is, however, impossible to administer tax laws with open eyes and escape observation of some of the underlying conditions which would be secondarily affected by the intercorporate dividend tax.

We see examples of legitimate and almost necessary uses of subsidiary corporations by those whose operations are widely spread geographically. A nationally owned business may find it almost necessary, and certainly expedient, to have subsidiaries in different States, often to comply with the requirements of the several jurisdictions as to qualifications for holding property or franchises. The Treasury would not favor a tax which would bear oppressively upon such legitimate operations.

At the same time we see other uses made of subsidiaries. For example, the public service corporation law in the State of New York prohibits a foreign corporation from owning more than 10 percent of the stock of certain utilities of that State. In 1928, one foreign corporation organized 10 subsidiaries, each of which owns 10 percent of the outstanding capital stock of one of New York's large operating utility companies, and, from an examination of the tax situation, no purpose whatever appears, except to circumvent the laws of New York.

Whatever the purpose to which these holding company systems have been put, outside of tax purposes, their effect on the revenue system is demoralizing and destructive of good administration.

The existence of these complicated systems has opened the door to operations which defeat stability of revenues, defeat enforcement, and multiply its costs.

The tax problems arising out of systems of holding companies, sub holding companies, operating companies, and mixed companies, are very serious. For example, one such system as of December 31, 1933, contained approximately 270 companies of which 128 were pub-

lic utility operating companies located in several and widely separated States, and at least 31 of which would be classed as sub holding companies. The corporation filed consolidated returns showing no tax due in any of the years 1929 through 1933. The system was not so modest about its profits in its reports to stockholders, and the Bureau began the task of audit. The auditing to date has required the services of 108 field agents for an aggregate period of 11,488 days, the services of 16 auditors for a period of 2,640 days, as well as the services of the supervising staff. The task is not yet nearing satisfactory completion. The investigation is complicated by the great volume of security transactions among the different companies of the group. In some instances securities were transferred through as many as 10 intermediary companies on the way from starting point to destination. A dollar of earnings would likewise run through several companies before reaching a resting place.

Some of these holding companies have imposed charges upon underlying operating utilities for the income-tax liability which the operating companies would have paid if they had filed a separate return. Then by eliminating the profit through the consolidated return, no tax was paid to the Government. The holding company had collected the tax and kept it for itself. One company collected from its subsidiaries between 1926 and 1929 in excess of one and one-half million dollars on this basis. This particular device is probably now defeated by withdrawing the privilege of filing consolidated returns.

Elimination of consolidated income-tax returns does not eliminate the necessity for auditing these gigantic systems, nor does it make the problem less difficult. Managements that are so disposed still find it possible to shift security transactions from one company to another for the purpose of allocating losses or profits so as to avoid taxes, and can still control and divert earnings from one to another unit in the form of service charges, accountancy, tax consultant, and management fees, and by various other changes can so reduce taxable income of some units and increase net income of others that they can accomplish many of the results of consolidated returns.

It is almost impossible, with systems of this magnitude and complexity, to determine the tax status of many companies. And, after an audit is made, the situation is easily and rapidly changed, to avoid its results.

In 1929, a certain corporation recorded on its books a capital gain in security transactions of \$18,000,000 which was eliminated through a consolidated return. The Bureau found, however, that there was no lawful basis for the consolidated return, and the resulting tax was about \$2,000,000. Nowever, it was then discovered that a letter, written in 1933, purported to confirm what was claimed to have been an oral agreement made in 1929, although it had for years been left unwritten. By its terms the two companies declared their transactions to be continuing and not to be finally fixed and determined until all taxes were finally paid. The object of the device was apparently to prevent the closing of the transactions in 1929 and to throw the profit in whatever year was found to be convenient.

Corporations that are parts of such systems find it relatively easy to strip themselves of their assets and to leave the Government without an easy method of collection. In some cases transferee proceedings may be available to recover assets. In other instances they are

extremely difficult. In one case a subsidiary exchanged bonds of the parent company for stock of the parent company on the basis of an apparent market value as of the date of exchange. The stocks received are practically worthless; the bonds still have some value. Transferee proceedings are difficult, to say the least, in reaching situations of this kind.

There is great danger that the Government will lose a very large tax, and that is not an isolated instance.

These corporations that are parts of such systems too often cease to be separate corporate entities. Their affairs become intermingled, their accountings confused and responsibility for their conduct separated in interest from the interests of the corporation itself and its minority stockholders.

Tax law has for some years encouraged and almost subsidized the growth of these systems. Stocks of our domestic corporations, when held by parent corporations, have had almost the same status as to the tax exempt privilege that the Government has given to its own securities. There was a distinct incentive to corporations to acquire investments in other corporations, and once acquiring investments, there were, of course, the usual incentives to acquire control.

Moreover, the privilege of corporate reorganization without recognition of a taxable profit often made it advantageous to effect consolidations or engage in other types of reorganization rather than to make sales outright.

The concentration of control of wealth has unquestionably proceeded at an even faster pace than the concentration of the ownership of wealth.

The concentration of control of wealth as distinguished from its ownership is not capable of statistical treatment with such accuracy as the concentration of ownership. The very purpose of corporate structures is to concentrate control by the management over the savings and earnings of the many stockholders, but of all forms, tax experience would indicate that the most vicious form of centralized control is that exercised through a system of pyramided corporations.

Its opportunities and temptations are far greater than those that beset the management of a single unit. The shifting of profits from parent to subsidiary or from one subsidiary to another in which the management may have a greater percentage of stock ownership, or the transfer of assets in exchange for stocks with a resultant benefit to the corporation in which the management has a greater share of ownership, or buying from and selling to controlled corporations, and market operations against the stockholders on inside information as to corporate structures which have grown too complex for anybody except the management to understand, are all matters which are forced upon the attention of those who have tax administration in charge.

So far as we can estimate, probable effects of a tax on intercorporate dividends would be these:

It would implement the graduated corporation income tax. As indicated in the President's message, if intercorporate dividends continue to be entirely exempted from taxation, there would be a powerful temptation for large corporations further to complicate their capital structures by organizing a series of operating subsidiaries, each one of which would be able to take advantage of the lower rates in the

early brackets. This would not only defeat the purpose of the graduated tax, but would positively pervert it by further complicating capital structures already too complicated. This may be prevented by taxing the dividends which would be received from such subsidiaries sufficiently to offset any tax advantage which might be derived from their creation.

Even aside from any considerations connected with the graduated corporations income tax I believe that such a partial withdrawal of the exemption now extended to intercorporate dividends would be desirable as a means of encouraging the simplification of corporate structures. Intercorporate dividends are largely unnecessary transfer brought about and multiplied by complex corporate structures. There are many examples of these complicated corporate structures in the public utility field, but the same thing runs throughout the entire field of industry.

Up until last year the Federal Government had done little or nothing to discourage such needless complexities. Last year a definite step was taken in this direction by the abolition of consolidated returns. The partial elimination of the exemption allowed intercorporate dividends would be a further step in this direction and would have the effect of discouraging the multiplication of intermediate holding companies and of encouraging the creation and maintenance of straightforward capital structures that can be understood by the average investor and public official.

Senator KING. That question is not before us in the bill that is before us?

Mr. JACKSON. The bill does not include the intercorporate dividend tax.

Senator KING. The House did not follow the President's message?

Mr. JACKSON. No; the House did not follow the President's message.

Senator KING. Or your suggestion, evidently.

Mr. JACKSON. It did not have my suggestions, I think. A comparison of the message and the bill shows that the House departed from the recommendation of the President in that respect.

It should be borne in mind that the cost of this tax will be felt in proportion to the abuse, and that many corporations and systems would be able to reduce greatly or eliminate the tax by the simplification of their corporate structures. Such a movement would simplify enforcement and increase the revenue.

I cannot give exact figures on the volume of dividends received by American corporations that would be subject to this tax as our income tax statistics have not been compiled in such a manner as to make this possible. We have, however, compiled estimates from such figures as are available, and it is on the basis of these data that we estimated the probable yield from this tax. These figures indicate that the total amount of dividends paid by one corporation and received by another during each of the past several years has been as follows: 1931, \$3,900,000,000; 1932, \$2,100,000,000; 1933, \$1,650,000,000; 1934, \$1,750,000,000.

For the year 1935, assuming a continuation of present corporate structures and practices, we estimate that this figure will be approximately \$1,900,000,000.

We therefore estimate the yield from reducing to 85 percent the present 100 percent exemption of intercorporate dividends from the corporation income tax to be \$39,700,000.

Senator KING. My recollection is that the Treasury Department, prior to 1934, favored consolidated returns.

Mr. JACKSON. I think that is true, Senator King.

Senator KING. So, the Treasury Department has changed now from its former view?

Mr. JACKSON. There has been a change of administration.

Senator KING. I understand. [Laughter.]

EXCESS-PROFITS TAX

Mr. JACKSON. One of the subjects which Secretary Morgenthau directed a study upon, in view of the comment and action taken with reference to it, is the excess-profits tax because that has been very much discussed and is, of course, included in the tax bill as presented by the House and there are some facts in our experience with the excess-profits tax which we think should be laid before this committee at this time.

Senator KING. May I inquire at this point: You are now presenting a bill that is not recommended by the President's message; he did not recommend the excess-profits tax?

Mr. JACKSON. That is right.

Senator KING. The Treasury Department, as I understand, is now presenting a bill that the President did not recommend?

Mr. JACKSON. No, I think when we get through you will see we are not. I am pointing out that when we get through, there will be before you the excess-profits tax proposal.

The experience we are having with this previous excess profits tax, we believe, has a bearing upon this proposition that will come before the committee, because we believe you will have both the President's message and the House bill to consider. We are not departing in any respect from the recommendations made by the President, but we are pointing out the effect of the two recommendations.

Senator KING. Let me see if I understand. Did Mr. Morgenthau, when he appeared before the Committee on Ways and Means, recommend an excess-profits tax?

Mr. JACKSON. He did not.

Senator KING. But you are recommending it now?

Mr. JACKSON. I am not. I am pointing out now, Senator, the experience we are having under this excess-profits bill as it now stands. But we think there are certain defects in it because if it is to be extended, as proposed in the House bill—and it, of course, is the constitutional function of the House to originate these measures—then I think you should have our experience so that this committee may arrive at a judgment as to the merits of the two proposals.

Senator KING. Are you now speaking for the Treasury in recommending an excess-profits tax?

Mr. JACKSON. I am not recommending an excess-profits tax, Senator, as you will see from my statement. I am pointing out the differences between the excess-profits tax and the tax recommended by the President. They are essentially different. We stand squarely on the President's message.

Senator KING. Then, you do not favor the provision of the bill as it is before this committee calling for an excess-profits tax?

Mr. JACKSON. I am not here opposing it. I am here giving you the facts about the excess-profits tax.

Senator KING. You are assuming a position of armed neutrality?

Mr. JACKSON. Well, I think it will be very apparent both as to the armament and as to the neutrality.

Senator KING. All right, proceed.

Mr. JACKSON. It has been suggested that the principle of the present excess-profits tax be substituted for, or added to, the principle of the graduated tax on corporate income. The adoption of either does not exclude the other. They are not inconsistent in principle, and while the application of both would be complicated, it is by no means impossible. Each is an effort to measure the burden by ability to pay and each takes a different measure of ability.

Whatever may be the merits of an excess profits tax, they are not the merits of a graduated corporation income tax; and it is illogical to propose one as a substitute for the other.

As a revenue producer, the graduated corporation income tax is apt to be far more stable than an excess-profits tax. The latter would be applicable mainly to unusual rates of profit, which are far less regular in their occurrence than corporation income as a whole.

Whereas a graduated corporation income tax, based upon size of income, recognizes the peculiar advantages of large business units in modern society, the excess-profits tax would fall upon small and large concerns alike. It is notorious that the risks facing small concerns are generally far greater than those facing large business organizations. It follows that unusually high rates of profit for small concerns are often only necessary compensation for the risks that they face and for their frequent losses. If small concerns were not able to enjoy good years, they could not withstand the competition of their larger and more stable competitors during poor years. The greater vulnerability of small corporations than large ones in periods of declining business activity has been mentioned.

The graduated corporation income tax, based upon size of income, is designed to recognize directly the advantages of size as a measure of ability to pay. An excess-profits tax would not be affected at all by the size of the concern; a peanut vendor being made subject to it at the same rates as those that would apply to a giant corporation.

The enjoyment of high rates of profit by small concerns during prosperous periods enables them better to withstand the heavier risks to which they are subject; and makes possible their growth. We do not wish to discourage the growth of small concerns. It is the existence of healthy and profitable small concerns that gives our economy the elasticity and flexibility in production and prices that are so valuable.

It is not to be disregarded, also that many of the services rendered by the Government are rendered corporations, directly and indirectly, according to their size, and not according to the rate of their profits. The mere maintenance of law and order, the regulation of transportation and communication systems, the provision of uniform currency and banking arrangements, and many others are of value to business corporations roughly according to their size.

The present excess-profits tax law has not been upon the books long enough to form a final judgment of its merit. It has been there long enough to develop some of its defects.

Capital stock tax returns filed under the present law have not been subject to a review as to their initial declaration of value. The capital stock tax collected for the year ending June 30, 1934, was \$80,000,000, which indicates a declared value of \$80,000,000,000.

Under the income tax law we collected during the same period, approximately \$400,000,000—

Senator KING. From the same corporation?

Mr. JACKSON. Not necessarily—no, Senator—which at 13¼ percent would indicate a corporate income of \$2,909,000,000 or a return enjoyed by all corporations of about 3.5 percent on the aggregate declared value. Capital stock returns, however, were made by a considerable number of corporations which reported no net incomes for the year—that answers your question—and eliminating those would tend to increase the percentage of net return of corporations having income.

The excess-profits tax paid during the fiscal year ended June 30, 1934, was approximately \$2,600,000, which would indicate the declared values were insufficient by \$416,000,000 to render corporations exempt from excess-profits tax if they had declared sufficient value in their original capital stock tax return.

It is evident that taxpayers are inclined to declare their capital stock tax value solely upon their expected net income rather than upon the basis of the true value of the capital stock as reflected in the capital invested in the business.

Two comments should be made on the excess-profits tax as it now stands. Net income subject to excess-profits tax does not include dividends. Therefore, the corporation whose income is made up of dividends from another corporation may declare a low valuation without subjecting itself to liability for excess-profits tax. One company into which assets of about \$90,000,000 were transferred, declared a value upon its stock, for the capital stock tax, in the amount of \$1,000,000. As the income of this company consists principally of dividends, this absurdly small valuation is safe from an excess-profits viewpoint. Many examples could be cited to show the advantage thus given to holding companies as against operating companies in the present capital stock tax law.

If a corporation has underestimated its net income, and in trying to keep to a minimum its capital stock tax, has subjected itself to a heavy excess-profits tax, there is nothing in the statute to prevent a nontaxable reorganization being effected on a basis that will permit a new declaration of value and escape from the future heavy excess-profits taxes.

It has also been suggested that the principle of the wartime excess-profits tax be combined with or substituted for the graduated tax on corporate incomes.

This tax was of outstanding importance during the war and was afterward abandoned, and the effort to base it upon the realities of excess profits led to difficulties in administration which were chiefly responsible for its abandonment. The present law is actually a capital-stock tax with an incidental excess profits tax feature of enforcement.

Senator KING. That is to prevent evasion?

Mr. JACKSON. Yes; but it does not prevent it, as pointed out.

The insignificant revenues from the excess-profits tax provision in 1934, amounting to only \$2,600,000, indicates its incidental character as compared with the capital-stock tax which yielded approximately \$80,000,000 during the same period.

It must be borne in mind that the unfortunate administrative experience with the real excess-profits tax began at a time when the Treasury was struggling with an income tax itself only 6 years old.

It does not seem necessary at this time to discuss the wartime excess-profits-tax experience and possibilities. While the administration of such a tax has been difficult, its problems do not necessarily forbid this type of taxation today.

Senator KING. You would prefer the graduated corporate tax to the excess-profits tax, would you not, if you care to express an opinion?

Mr. JACKSON. I would prefer to see the recommendations of the President's message carried out literally and fully.

Senator KING. And that, of course, would exclude the excess-profits tax?

Mr. JACKSON. If the Congress sees fit to enact the excess-profits tax, to supplement it, we will try to administer it.

Senator KING. But you pointed out the difficulties of administration?

Mr. JACKSON. I would not advocate it as a substitute, and it cannot be regarded as a substitute for the recommendation of the President.

Senator KING. I would like to ask one or two more questions. Would you care to explain to us where you would suggest we start graduating the surtaxes under the bill?

Mr. JACKSON. Where I would suggest we start graduating the surtaxes under the bill?

Senator KING. Yes.

Mr. JACKSON. Well, as Secretary Morgenthau has already stated the position that the Treasury would not suggest rates, I would not care to go into that.

Senator KING. You would leave it to the wisdom of this committee?

Mr. JACKSON. I would leave it to the wisdom of this committee or Congress.

Senator GORE. Do you think a graduated tax on corporations has any necessary relationship to the ability to pay?

Mr. JACKSON. Before you came in, Senator Gore, I went into that subject at considerable length.

Senator GORE. I am sorry.

Mr. JACKSON. Students of the subject have generally agreed, entirely apart from those who favor this bill—in fact, those who do not favor it agree—that the more stable income is enjoyed by the larger corporations and that their current asset position is, on an average, better.

Senator GORE. Now, taking the United States Steel: It has been running along at a loss for 3 or 4 years. Do you regard that as not being a typical concern?

Mr. JACKSON. Of course, during the time it is running at a loss, Senator, it would have no tax to pay.

Senator GORE. That is true. But that is not the point. You are making the proposition that there is income received.

Mr. JACKSON. Yes.

Senator GORE. Take the American Woolen Co. Is that in the same position? Now, this proposed graduated tax on incomes. Is not that, as you indicated, a few minutes ago, a tax on size, without relationship to ability to pay? Is it not an effort to make it serve some economic end or social end, other than the raising of revenue?

Mr. JACKSON. I think not, Senator Gore.

Senator GORE. Then, what is it?

Mr. JACKSON. I think, as I pointed out, that the more stable revenues will be derived by the Treasury, as it leans more largely on large corporations, because they are shown to have, up to the date of our present studies, at least, the more stable income.

Senator GORE. I could see how that would have pertinence to your excess-profits tax. I think that point is well taken, but I do not see how it has any proper relationship to corporate income.

Mr. JACKSON. Well, this is the situation as the studies show: Your small corporations make more money, in percentage, and make it quickly; conversely, they go down more quickly and go down farther. Your larger corporations run right along on a more even keel. They do not go up so high nor do they go down so low. The indications are, that, as an average, the large corporations have more stable income.

Senator GORE. I think that is sound argument.

Mr. JACKSON. I think this is where it has a bearing on the graduated income tax. In the first place, we are interested in stable revenue. Fluctuating revenue is a weakness in the income-tax structure. The more we rely for our revenues upon those corporations which are more stable and the less we rely upon those corporations which fluctuate so much, the more stable our resulting income to the Government will be.

Senator GORE. I can see that point. Then, why not have a fixed rate at a point which will meet the Government's requirements in all contingencies?

Mr. JACKSON. Because a fixed rate would apply equally to the small corporation and to the large corporation.

Senator GORE. It would not apply to the small corporation if it did not make money and if it did make money it should pay.

Mr. JACKSON. That is right; but when it makes money, it is really simply offsetting losses of previous years. Therefore, I think the Government should graduate its tax on the larger and more stable corporation income.

Senator GORE. Do you not think that it is a more correct economic principle to impose a fixed rate than impose an unfair tax upon stockholders of a big concern, which happens to have holdings which are relatively large?

Mr. JACKSON. I pointed out, Senator, that this argument with reference to the large number of stockholders and the effect upon their income is a very good argument, of course, for the opponents to make, but it does not stand analysis.

Senator GORE. Now, the American Telephone & Telegraph has 650,000 stockholders. I do not know whether you regard that as a pretty wide distribution or not. How do you regard that?

Mr. JACKSON. It is a wide distribution, if you take those figures alone. However, I understand that their largest stockholding does not exceed 1 percent. If you take the stockholders and break them down you will find the proportion of the income of the A. T. & T. which goes to the small stockholders and apply that proportion of the income to their total income, you will find that the dividends are an insignificant thing to apply to any \$5,000 income. When you reach the people with million-dollar incomes, you will find that their dividends are 50 percent of their total incomes.

Senator GORE. How many come within this increase in these high income-tax rates? How many individuals are in that position? We had it the other day—I think it was 50 or 60.

Mr. JACKSON. There are 50 over a million. The total number—

Senator GORE. It looks like, when you figure it out, that nobody much will be affected. It simply does not seem to check.

Now, take General Motors: They have 340,000 or 350,000 or 360,000 stockholders and the United States Steel 250,000.

Now, Mr. Jackson, have you broken this down into categories, so that you can show the big concerns and their incomes over a period of years and the typical small concerns, averaged over a period of years?

Mr. JACKSON. We have broken down five corporations as to their 1930 income which of course was high, in order to show—and I have filed tables showing the effect of that income—in order to show the effect of the graduated tax on those corporations, per share.

Now, when you come to translating it into its effect upon particular stockholders or stockholders' groups, you must have information that is not available. You must have the break-down as between large and small stockholders of the corporation.

But, if you will break it down you will find that you have a large number of holdings in these corporations of 2, 4, 6 shares. There are a great many of those. Numerically, they run very high. Then you will find that the control of the corporation—the actual important economic results—is in the hands of the people who hold much larger blocks of stock.

Senator GORE. I think here is the main concern about this graduated tax on corporations. You think that a tax on size is a good tax, as far as raising revenue is concerned; you advocate it on that ground. Maybe you are right. Whenever you deviate from the principle of levying taxes for the purpose of raising revenue, with no other purpose, you set a dangerous precedent, because somebody may come in power some day and say, "Well, Jackson took that position; so, we will levy taxes for something else than revenue also." It is a dangerous precedent. You and I, of course, may not agree on that.

Mr. JACKSON. Of course, the enactment of a tax law is entirely in the hands of Congress, and if the people change their minds about the situation, that is something that is entirely within their province.

Senator GORE. I am an Irishman and I have a keen sense of humor and I can appreciate that. [Laughter.]

Senator KING. I think, Mr. Jackson, if you intend to convey the view that we ought to attempt, as a thesis of taxation, a tax because of size, and a tax because of the social benefits alleged to accrue, rather than to obtain revenue, you are, as indicated by the Senator from Oklahoma, going into a very dangerous field.

Mr. JACKSON. As far as the philosophy of the tax is concerned, I have nothing to add to the message of the President and do not intend to be amplifying or detracting from it.

Senator KING. Or enunciating any philosophy of taxation?

Mr. JACKSON. I am giving you these facts and do, as far as I am concerned, accept gladly the philosophy which the President has stated in his message.

Senator GORE. You think that is sound?

Mr. JACKSON. I do.

Senator GORE. Let me ask you this: I have a friend in Oklahoma who organized an independent oil company a few years ago and made a success of it. When the crash came he undertook to protect his stockholders but could not do it and went broke.

After 3, 4, or 5 years of struggling he has finally hit it lucky again. He has brought in an oil field for which he has been offered \$10,000,000; and I understand that if this bill passes and he accepts that offer, he will get \$1,500,000 out of it and will pay \$8,500,000 in taxes of one sort or another; and I am wondering if that does not discourage enterprise in a business like the oil business where there is so much risk and hazard. Do you think that is fair?

Mr. JACKSON. Of course the oil business is notoriously uneven, and the example which you have selected might or might not work out. I have found that when these men make their tax returns they do not always correspond to the views which they entertain about tax bills that are pending. I am not so sure that he will return that he owes the Government \$8,500,000 taxes.

Senator GORE. I do not imagine he will. I think he will spread it over 25 years, just in order to avoid this ruinous taxation, just as another concern has done.

Mr. JACKSON. I would not anticipate \$8,500,000 of revenue from that transaction.

Senator GORE. Anyway, that is legitimate and within the law and if, to avoid annihilation, it is used I think it is justified.

Senator KING. Are you willing to indicate, Mr. Jackson, where we should start taxing inheritances?

Mr. JACKSON. I think that that question was substantially covered by the Secretary in the statement that the Treasury did not want to suggest rates or brackets, and I would not presume to—

Senator KING. You do not want to amplify that?

Mr. JACKSON. I do not want to add to his statement on that subject.

Senator KING. You do not want to amplify the statement made by the Secretary?

Mr. JACKSON. I would not care to.

Senator KING. How do you interpret the President's message as to where he intended to start increasing the surtaxes and as to where he intended to start taxing inheritances?

Mr. JACKSON. I do not read the message as stating the point at which they should start. I read the message as using the one million dollars, or the inconsistency above a million dollars, as an illustration. I think that is a figure that the President uses to illustrate, and I do not read it, for myself, as a limitation upon the recommendation.

However, I do not wish to be understood as amplifying or interpreting the message in any official sense. You can read it quite as well as I.

Senator KING. In view of your attitude of taciturnity upon these important questions, I will not pursue them.

I mentioned a few minutes ago the attitude of the Treasury Department with respect to consolidated returns, and I have here the statement made by Secretary Morgenthau, when Acting Secretary of the Treasury, in December 1933, with respect to consolidated returns. He stated, in the judgment of the Department, the law should not be changed in this particular.

I suppose the Treasury Department is permitted to change its mind as well as other people.

Mr. JACKSON. Since that time, as I recall that date—that was about the opening of the administration—since that time I think we have learned a great deal about the income tax law, as it is administered; if we have not, we have wasted a lot of time, and I think what we have learned points to some different conclusions than we might have entertained when we entered upon the work.

Senator KING. Thank you very much, Mr. Jackson.

We will now hear from the Honorable William D. McFarlane, a Representative in Congress from the State of Texas.

Now, I do not want to try to cramp anyone, but we are very much limited in time.

Mr. McFARLANE. How much time will I have?

Senator KING. How much do you need, and I can answer you better. The less time you require the better, in view of our efforts to attempt to get through. Will 10 minutes be sufficient?

Mr. McFARLANE. I would like to have 15, if I can get it.

Senator KING. You may proceed.

STATEMENT OF HON. WILLIAM D. McFARLANE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. McFARLANE. Mr. Chairman and gentlemen, I have just a few observations I want to make to you gentlemen in view of the conditions existing in this tax bill at this time, realizing there is a little more liberal element over here in the Senate than there is in the House. I am, perhaps, presuming a great deal in coming over here, giving to you gentlemen my views on the taxation.

Senator KING. I might say I read your remarks as delivered in the House.

Mr. McFARLANE. Based on those remarks, may I have the privilege of revising and extending the remarks I will make here and to include certain tables and excerpts.

Senator KING. You may have that privilege.

Mr. McFARLANE. What I wanted to particularly address myself upon to you Senators is the provision of the tax law as it now stands, and also in regard to titles II and III, particularly, of the new tax set-up on gifts to donee, and inheritance tax, and suggest to you why I think we should increase the rates of existing gift taxes and estate taxes rather than go into this new field of taxation as prescribed by the House bill as it now stands.

I am familiar with the President's recommendations, and where the House has deviated from those recommendations. I have also heard the comment that Mr. Jackson has made upon that, with which comment I am in hearty accord.

The only difference I would suggest, except those existing in the House bill contrary to the President's recommendations, I believe we should put a ceiling on personal incomes. I believe that about \$1,000 a week net income, after all allowable deductions and exemptions are allowed under the present circumstances, and under the condition of the country, would be ample.

We realize that the surtaxes set up in the House bill will affect less than 8,000 incomes, according to the information furnished us in the House report.

I believe we ought to establish a system of taking a percentage of rates, and from the present exemptions go forward with those rates, and if 1 percent above exemptions is too great, then half a percent, and continue on up, and I think that that policy is sound.

If you gentlemen think \$50,000 net income is too low, then one-half of 1 percent under the tables announced would net \$100,000 income. I call that to you gentlemen's attention for the reason that the rates under such a table would bring in much more revenue, based on ability to pay, than the present tax rates as amended by this bill will realize to the Treasury Department.

Senator KING. In other words, your position is that no income should be permitted in excess of \$50,000, and we should take all above that by taxation.

Mr. McFARLANE. I agree with that principle.

Senator KING. I do not agree with that principle.

Mr. McFARLANE. I realize there are a great many people that do not agree with it.

INHERITANCE AND GIFT TAX ON DONEE EXEMPTIONS

Going now to titles II and III of the House bill, I think titles II and III of the bill are nothing more than an empty gesture in taxation. The only person that can reasonably be expected to pay any taxes under these titles is the unsuspecting and conscientious taxpayer who refuses to consult a capable tax attorney. Section 205 (b) of title II permits a beneficiary in the case of father, child, grandchild, grandfather, grandmother, and brother to receive \$50,000 free of tax. Section 305 of title III permits an exemption of a similar amount from the gift tax. The possibilities of evasion under these provisions are bounded only by the inventive genius of the taxpayer's lawyer.

To illustrate, suppose A, an individual, desires after passage of this bill to avoid the taxes imposed. Let us see what he can do without incurring liabilities for one dollar of tax. Assume that A has five children, each of whom has five children. A is permitted under section 305 of title III to give each of his grandchildren and children \$50,000 each or \$1,500,000, and in addition thereto an annual allowance of \$5,000 each, or an aggregate of \$150,000, making a total of \$1,650,000. A under section 205 (b) of title II can also will each child and grandchild \$50,000 free from tax or an aggregate of \$1,500,000. Thus \$3,150,000 has been transmitted free of the taxes imposed by this bill. If, however, A finds he has many millions left he can then largely reduce his taxes by creation of future interests, which under the provisions of the bill will largely postpone any tax on the remainder of his estate. Added to this fact is the possibility of further reducing the tax by spreading out his estate over as many relatives as possible.

A, however, does not have to wait until the passage of this bill in order to defeat the tax in the manner described above. The Supreme Court of the United States in *Coolidge v. Long* (283 U. S. 15) held that property transferred in trust, title to which became vested prior to the passage of an inheritance tax law in the State of Massachusetts, was not subject to inheritance tax upon the death of the creator of the trust. A therefore can transfer his estate prior to the final enactment of this bill in trust so as to vest title in the beneficiaries and escape the entire death taxes imposed by this bill.

In addition to the foregoing obvious loopholes, the bill provides for exemption of dower and courtesy or the statutory allowance in lieu of dower. This in itself reduces the estate by substantial amounts. For example, the dower in some States is one-third the real property and in addition thereto one-half the personal property.

The tremendous obstacles in the way of administration are sufficient in themselves to make it inadvisable to approve these provisions of this bill. New York State, under the able direction of Mr. Mark Graves, an outstanding expert on death duties, conducted a very thorough investigation of the inheritance tax. As a result of the State's experience and in the light of the commissioner's findings the State of New York dropped the inheritance tax which it had adopted many years ago and substituted in its place the estate-tax form of death duties. There is a decided trend in the various States having the inheritance form of taxation to change over to the estate-tax form.

In my view I can see no reason why at this time we should experiment with a form of taxation that holds out little hope of revenue and offers so many possibilities of evasion and so many difficulties of administration. After all, the entire death-tax burden must come out of the estate. The bill provides that the executor is personally liable for all death duties. If it is desirable to take a greater amount of death duties, this result can be accomplished without adding any additional administrative duties and without any possibility of any taxpayer escaping the additional tax. This can be accomplished by increasing the present estate and gift taxes, and I introduced bills to that end, H. R. 8402 and 8403. Under such an amendment transfers made while the bill is under consideration in contemplation of death can also be reached. The Supreme Court in the decision of *Milliken v. United States* (283 U. S. 582) has made this beyond a question of doubt.

v. U. S. (276 U. S. —), has made this beyond a question of doubt.

Senator KING. You may have the privilege of extending your remarks if you desire.

Mr. McFARLANE. I wanted to make that suggestion if I could and call this also to the attention of the committee in passing, that all of the loopholes in the present revenue law should be closed.

Senator KING. If you can make any suggestions on how to close those loopholes, the committee will welcome them.

Mr. McFARLANE. I know the committee is busy, and I will make additional suggestions in my extended remarks.

Mr. Chairman and gentlemen, in examining the House bill now before you, we find that this measure deviates from the expressed wishes of the President in several particulars.

It does not meet his suggestions—

1. On the increased rates on surtaxes.

2. On graduated corporation taxes.
3. Tax on intercorporate dividends.
4. As to excess-profits tax.

The House Ways and Means Committee estimates that the bill before you will bring in \$270,000,000 as follows: Increased surtaxes, \$45,000,000; graduated corporation tax, \$15,000,000; excess-profits tax, \$100,000,000; inheritance tax, \$86,000,000; gift tax, \$24,000,000.

The reason for this bill at this time is the great emergency existing and the emergency expenditures now being made, causing great need for additional revenue. If we recognize the principle in the enactment of this measure of taxing the wealth of the Nation based on ability to pay, we must seriously consider taking out the loopholes provided in this bill as well as eliminating the loopholes existing in the present income-tax law and then revise our rates upward considerably under the rates contained in the bill.

INCOME TAX

The amendments in this bill provide higher surtax rates on net incomes in excess of \$50,000, which will affect less than 8,000 incomes and is estimated to produce \$45,000,000 additional revenue. I believe we should place a ceiling on personal incomes so that whatever tax is collected will not be shifted to the consumer. I recommend a 1 percent tax on the first \$1,000 above exemption and increasing 1 percent with each additional \$1,000, which would limit the net personal income to about \$1,000 per week. Such an amendment up to incomes of \$100,000 would be comparable with the rates now in effect in Great Britain, France, and Germany as shown by the following table:

Comparison of income tax—married person, no dependents, all income from salary

	McFarlane amendment	Great Britain	France	Germany
\$1,000.....	\$0.00	\$8.88	\$33.78	\$79.05
\$2,000.....	0.00	111.44	170.10	316.85
\$3,000.....	8.00	311.44	365.85	543.54
\$5,000.....	85.00	711.44	857.30	1,079.54
\$7,500.....	230.00	1,221.94	1,651.30	1,951.95
\$10,000.....	440.00	1,862.34	2,524.94	2,989.89
\$15,000.....	1,049.00	3,443.85	4,688.28	5,170.49
\$25,000.....	3,049.00	7,368.90	9,509.83	9,946.04
\$50,000.....	12,516.50	19,654.60	23,716.05	22,565.71
\$100,000.....	50,204.00	48,101.85	53,651.12	47,445.63
\$500,000.....	463,866.50	307,909.85	269,651.12	247,465.73
\$1,000,000.....	961,366.50	639,159.85	539,651.12	497,446.16

BENEFITS DERIVED FROM LIMITING INCOMES TO \$50,000 PRESENTS UNHEALTHY INCREASE IN PRICES AND REMOVES INCENTIVE TO REDUCE WAGES

Such an amendment to our tax laws would peacefully and orderly bring about a redistribution of our national wealth. These amendments would soon be reflected to both the consumer and producer. Business men who are prone to reduce wages or oppose their increase would not find it advantageous to do so if the resultant savings when beyond their reasonable needs was taken from them in taxes. Like-

wise, the incentive to reap excess profits by increasing the selling price would cease to exist. Instead the tendency would be to maintain good wages, shorten hours, and decrease prices to the lowest point compatible with this maximum possible personal income. The increased wages, shorter hours, and decreased selling prices would automatically benefit the whole community by increasing employment and buying power.

WOULD REMOVE THE INCENTIVE FOR UNREASONABLE INCREASES IN
OFFICERS' SALARIES

The Federal Trade Commission has been engaged in compiling data on the salaries of some of the larger corporations. Under date of February 27, 1934, the Evening Star of this city quoted an article from the Associated Press to the effect that this study disclosed that out of 900 big companies around 300 executives were receiving more than \$100,000 in 1929 in bonuses and salaries. In the boom period about two score received pay checks and bonus of \$200,000. Some 25 got between \$200,000 and \$300,000; 7 more got between \$300,000 and \$400,000; 3 between \$700,000 and \$800,000; 2 between \$800,000 and \$900,000; 1 something over a million and another more than a million and a half.

A conspicuous example was that of president of the American Tobacco Co. who between 1929 and 1932 received in bonuses and salary \$3,000,000. Another case was that of the president of the Bethlehem Steel Co. whose annual salary from 1928 to 1930 was \$12,000 annually but whose bonuses averaged \$1,100,000 per annum. A more glowing example was that of an executive of Fox Film Co. who received a salary and bonus of \$460,000. Shortly thereafter the company under his management was in financial difficulties. The Associated Gas & Electric Co. with the large bonuses and salaries paid its officers, while the stockholders are paid no dividend, is a glaring example of why such an amendment as herein suggested should be adopted.

While I do not have sufficient data to establish this statement, it is generally conceded by those in a position to have a knowledge of industry that salaries were increased from 1916 to 1929 by several hundred percent. In most instances these increases were not justified on the basis of additional duties. The additional pay in no sense represents earned incomes but are paid by reason of the fact these individuals are able to dominate and control oftentimes with very little actual ownership of the business. The excessive salaries which they receive represent accumulated profits diverted from the stockholders into their pockets. The salary of the President of this country is only \$75,000. I believe no officer in commercial enterprises should receive more.

WOULD TAKE FROM THESE INDIVIDUALS THE MEANS BY WHICH THEY
ACCUMULATE UNREASONABLE WEALTH

The executives of large corporations for the most part are in a position to have inside information about the possibilities of profits from trading not only in their own stock but that of other companies dominated by friends and associates in like positions. Much of the

profits from capital gains reported by wealthy men undoubtedly was the result of confidential information reaching them by reason of their position in the financial world before such information trickled down to the public. The exorbitant salaries and bonuses is the starting point frequently by which enormous amounts of wealth are accumulated from trading in stocks of this kind. The officers of General Motors, Chrysler, and Studebaker are said to have amassed large sums in this manner.

WILL REMOVE NUMEROUS ECONOMIC EVILS

Many economic evils and practices that are common under the present system would not be practical or profitable with such a progressive personal income tax. Holding companies, trusts, monopolies, and other devices for making and covering up excess profits would be of no avail. All such profits would ultimately be passed on as personal income and so would be available for taxation.

The temptation to water stock would be much lessened. Stocks are watered so that a few at the top may reap a bounteous harvest without giving anything in return. What would be the advantage of such manipulation if most, or all, of the profits reverted to the people through taxation?

The proposed tax would make large holdings of unproductive natural resources unprofitable or impossible and so help to restore such resources to the people. It would tend also to break up all large fortunes and holdings however owned or controlled. We would have no millionaires or wealthy playboys, also fewer paupers.

The perennial warfare between labor and capital would be largely avoided by such tax. Labor troubles are usually due to the desire of the employed for a more equitable share of the profits of industry. Given such a share, the conflict should cease.

Undue political influence and power that so often goes along with great fortunes and incomes would naturally be much less when such fortunes and incomes no longer exist.

Such a tax would take the excess profits out of the munitions and ship-building industries. It would thus help to eliminate one of the potent factors that tends to promote war.

I realize that the income-tax law is full of exemptions and deductions favorable to wealthy taxpayers. Many of these deductions permit the taxpayer to retain, free of tax, large amounts of actual profits. The limitation, therefore, of \$50,000 is far less than the taxpayer will be permitted to retain under the existing law. For example the capital-gain provision exempts from tax as high as 70 percent of the profits realized from the sale of stocks and bonds and other property. Statistical data of the Bureau of Internal Revenue indicates that wealthy taxpayers have a very large percentage of their net income from this source. It is commonly known that these gentlemen buy stocks, bonds, and real estate when the markets are depressed, and the public has little cash for this purpose.

These investments are held until prosperous times, when the markets are inflated, and their investments are then liquidated at excessive prices, a large portion of property sold by this class falls into the hands of small investors, who oftentimes lose much of their hard-earned money in the recessions of the market, when the shrewd

investor can buy them up again for another cycle of investment. I see no reason for retaining such loopholes in the law, but if they are to be retained the rate of tax should be exceedingly heavy on that portion of the income subject to tax, for the profits they receive from these investments are not truly earned but represent the wealth of many small investors who are stripped of their savings, which are transferred to the wealthy individual who can take advantage of the economic condition of the times.

ESTATE TAX

In the case of estates I recommend a schedule beginning with 2 percent on the first \$10,000 in excess of the exemption of \$50,000 provided by the revenue act and is graduated upward to a rate of 99½ percent on net incomes in excess of \$20,000,000. The rate schedule is so drawn that regardless of the wealth there remains not over \$5,000,000 to be distributed in the case of any estate.

Comparison of estate tax under this amendment and Great Britain is as follows:

Net estate before exemption	McFarlane amendment	Great Britain	Net estate before exemption	McFarlane amendment	Great Britain
\$2,500-----	None	\$25	\$400,000-----	\$62,600	\$72,000
\$5,000-----	None	100	\$500,000-----	82,600	95,000
\$25,000-----	None	750	\$600,000-----	102,600	120,000
\$50,000-----	None	2,000	\$800,000-----	150,600	192,000
\$100,000-----	9,600	8,000	\$1,000,000-----	206,600	240,000
\$150,000-----	17,600	15,000	\$2,000,000-----	546,600	600,000
\$200,000-----	26,600	24,000	\$5,000,000-----	2,026,600	1,900,000
\$300,000-----	44,600	48,000	\$10,000,000-----	5,726,600	4,500,000

WHY THESE AMENDMENTS SHOULD BE ADOPTED

I recommend for consideration of this committee the rate schedules which I have proposed in the foregoing amendments. I believe that these rates are necessary to carry out the purpose stated in the President's recent message dealing with the subject of taxation.

In regard to our policy of taxation the President says:

Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power.

In further recognition that taxes should be levied in proportion to ability to pay, the President says:

Taxation according to income is the most effective instrument yet devised to obtain just contribution from those best able to bear it and to avoid placing onerous burdens upon the mass of our people.

And further recognizing the justness of the movement toward progressive taxation of wealth and income, the President says:

Wealth in the modern world does not come merely from the individual effort; it results from a combination of individual effort and of the manifold uses to which the community puts that effort. The individual does not create the product of his industry with his own hands; he utilizes the many processes and forces of mass production to meet the demands of a national and international market.

Therefore, in spite of the great importance in our national life of the efforts and ingenuity of unusual individuals, the people in the mass have inevitably helped to make large fortunes possible. Without mass cooperation great accumulations of wealth would be impossible save by unhealthy speculation. As Andrew Carnegie put it, "Where wealth accrues honorably, the people are always silent

partners." Whether it be wealth achieved through the cooperation of the entire community or riches gained by speculation, in either case the ownership of such wealth or riches represents a great public interest and a great ability to pay.

In line with the thought expressed in these quotations, I recommend the limit which anyone should receive as \$5,000,000. I believe that this country would be better off with a great many persons of small wealth rather than a less number of very great wealth. France and England are examples today of countries in which there are very few men with extremely great wealth. As a matter of fact, I do not understand that any individual in either of these countries possess anything like the wealth of the Ford family or the Mellon family. The recovery which each of these countries made after the war shows on how stable a basis their social structures rests. If we are to provide opportunities for persons of small means, it is incumbent upon the Government to effectively check the growth of large groups of wealth. This can be effectively done only if rates of income tax, inheritance and gift taxes are amended which will limit the amount of wealth remaining in the hands of the family at the date of death. I believe that the limit fixed in the amendments which I have suggested will do this in an effective way.

GIFT TAXES

Under the present law, gifts are taxable at rates 75 percent of rates of similar amounts left by inheritance. The savings in tax which can be effected by means of giving away property prior to death is so large in the case of wealthy taxpayers that a substantial portion of their inheritances will be given away to their children prior to death in order to defeat the inheritance-tax laws. The rates on gifts should be the same as inheritance rates. This will partially discourage the giving away of property merely to defeat the tax. It will not, however, prevent the giving away of property prior to death for that purpose. The tremendous saving which can be effected under the present law is indicated by the following figures. In the case of an estate \$10,000,000 the total estate tax is \$3,094,500. If, however, the decedent gives away one-half of the property prior to his death, the gift tax on one-half of the property is \$848,650; the estate tax on the remaining one-half is \$1,149,500, making a total tax of \$1,998,150 and the saving to the estate is \$1,096,350.

The following data taken from reports of the Bureau of Internal Revenue showing receipts of gift taxes for 1933, 1934, and 1935 by months indicates taxpayers are availing themselves of this loophole to reduce death taxes:

Month	1933	1934	1935
July.....	\$2,832.87	\$15,098.84	-----
August.....	5,322.34	25,131.33	-----
September.....	9,091.20	67,142.91	-----
October.....	11,502.91	13,086.17	-----
November.....	30,568.78	166,139.01	-----
December.....	186,103.58	243,031.28	-----
January.....	-----	1,764,987.87	\$51,832.79
February.....	-----	997,601.68	382,132.77
March.....	-----	7,369,435.04	64,339,757.17
April.....	-----	694,268.21	3,024,711.09
May.....	-----	252,558.48	430,271.87

I urge that you substitute higher estate-tax rates for the additional estate-tax rates imposed by the Revenue Act of 1934. Such a tax in view of decisions of the Supreme Court will reach a large portion of the transfers which are certain to be made in anticipation of an inheritance tax.—*Milliken v. United States*, 283, U. S. 15.

Under the situation now existing, gifts will all be consummated before the law becomes effective. However, under the very liberal exemption allowed under this and existing law, even if such transfers are not made it will still be very advantageous to wealth to make gifts for it will split the gift-, estate-, and inheritance-tax provision and will keep out of the higher bracket rates. The more separate taxes with their complex allowances, deductions, and exemptions, the greater the chance for tax evasion. I have already referred to the wide-open exemption provisions included in this bill; it is well known that under the tax law that gifts set up for escaping income tax have been approved—Moores, 3 B. T. A. 301; Zinn, 3 B. T. A. 974; Twining, 32 B. T. A.; Bailey, 3 B. T. A. 362; Walsh, 18 B. T. A. 571; Clark, 31 B. T. A. 1082. If the husband wants to use the proceeds he "borrows" them from the wife, and this is proper according to the Board. See Bailey, *supra*.

Transfers made in contemplation of death are approved by the Board. In contemplation of death, transfer by man 84 years old, Wanamaker Estate, 16 B. T. A. 15; 78 years old, Pacific Southwest, and so forth, 14 B. T. A. 72; United States Trust, 24 B. T. A. 312; Lozier, 7 B. T. A. 1050, and Schultz, 7 B. T. A. 900; all similar.

Exemptions are very liberally construed. See Federal Subsidies Through Tax Exemption, by H. S. Van Alstine, XIV Proceedings of National Tax Association, 1921, pages 459-472. Also see Digest and Index of Proceedings of National Tax Association.

It is hoped that we are now emerging from the most serious depression in the world's history. Experience teaches us that the wealthy during such depressions acquire large volumes of property at bargain-counter prices. The unhealthy condition by reason of accumulation of wealth in hands of too few persons will be greatly aggravated by reason of the profits realized from the purchase of property during the depression. These profits represent the earnings of the great masses who by reason of their unfortunate condition are unable to hold to their property until normal times. I believe death taxes should be imposed sufficiently high to return a large portion of such wealth to the Government in order that it may be used to liquidate the obligations of the Government now being created for relieving the distressed people of this country.

On May 17 I pointed out in a speech in the House that 3¼ percent of the people own 87 percent of the wealth of the Nation; that, according to the latest information available, only 2,083,153 people have incomes exceeding \$2,000 per year, which incomes are regarded sufficient only for basic necessities.

The Conference Board Bulletin, April 10, 1935, analyzed the national income produced from 1899 to 1934 and makes this interesting comment on the analysis submitted:

National income—the net value of the goods and services produced by the Nation's gainful workers—amounted to \$47,600,000,000 in 1934. Compared with \$41,800,000,000 in 1933, this represents an increase of 13.9 percent. In the same interval wholesale prices of commodities increased 13.7 percent, while the cost of living of wage earners rose 6.1 percent. The effective increase of national

income, measured by purchasing power, was, therefore, considerably less than the nominal increase, measured in dollars.

Comparing 1934 with 1929, when national income reached its highest level, \$83,000,000,000, it is found that the income level declined 42.7 percent, wholesale prices 21.4 percent, and the cost of living 20.6 percent. The purchasing power of the national income produced in 1934 was, therefore, about 27 percent below the predepression peak.

While national income produced represents the earned income from production, it does not necessarily coincide with the combined income that is paid out or distributed to individuals as wages, salaries, and other labor income, rents and royalties, interest, dividends, and withdrawals by proprietors and partners. During the depression years 1930-33 estimates of the United States Department of Commerce indicate that income paid out exceeded income produced by about \$27,000,000,000. (Details, by industries, are given in National Income and Its Elements, Conference Board Bulletin, May 10, 1934.) The deficiency was met out of previously accumulated business assets.

National income produced, 1899-1934

Year	Total (billion dollars)	National income		Index of wholesale prices, all commodities (1926=100)
		Per capita	Per gainful worker, including unemployed	
1899	15.6	\$209	\$547	52.2
1900	16.2	213	556	56.1
1901	18.3	235	610	55.3
1902	20.8	262	674	58.9
1903	21.1	261	664	59.6
1904	21.6	262	661	59.7
1905	25.1	298	747	60.1
1906	27.6	322	800	61.8
1907	28.2	322	796	65.2
1908	24.9	280	684	62.9
1909	27.2	300	727	67.6
1910	30.1	326	785	70.4
1911	29.4	314	761	64.9
1912	31.8	334	814	69.1
1913	33.7	350	857	69.8
1914	32.0	327	806	68.1
1915	34.5	347	860	69.5
1916	44.2	439	1,093	85.5
1917	53.2	521	1,304	117.5
1918	60.2	581	1,463	131.3
1919	67.4	642	1,623	138.6
1920	74.3	697	1,770	154.4
1921	52.6	486	1,233	97.6
1922	61.7	562	1,423	96.7
1923	69.8	626	1,584	100.6
1924	69.6	615	1,555	98.1
1925	77.1	671	1,695	103.5
1926	78.5	674	1,699	100.0
1927	77.2	653	1,647	95.4
1928	80.5	671	1,691	96.7
1929	83.0	683	1,719	95.3
1930	70.3	571	1,436	86.4
1931	54.6	440	1,107	73.0
1932	39.4	315	793	64.8
1933	41.8	333	836	65.9
1934	47.6	377	946	74.9

Per capita income of \$377 was produced in 1934. This figure is 44.8 percent below the 1929 level, in dollars, and 30 percent below it in purchasing power. The average income produced per gainful worker, including the unemployed, was \$946 in 1934, as compared with \$1,719 in 1929.

The accompanying table and chart shows the total income produced, the income per capita of population, and per gainful worker from 1899 to 1934. The column of index numbers of wholesale prices, expressed in terms of 1926 as 100, furnishes an approximate guide regarding the extent to which rising incomes have been offset by rising prices, and vice versa.

These estimates of national income produced have been derived from a number of sources, adjusted in some instances to preserve continuity of concept. Figures for 1924-28, 1933, and 1934 are estimates of the National Industrial Conference

Board. For 1929-32, United States Department of Commerce estimates of income produced have been used, as given in its report, National Income, 1929-32. For 1918-23, the Federal Trade Commission's estimates of national income in its report, National Wealth and Income, correspond to the production concept. For 1909-17, the estimates by D. W. I. King of the National Bureau of Economic Research, have been adjusted, mainly by eliminating "Imputed income" from ownership of durable goods (including owned homes). For 1899-1908 estimates by Dr. Warren M. Persons have been incorporated in order to carry the series back to the turn of the century.

Our leading economists agree that \$2,000 is the minimum annual income "sufficient only for basic necessities" for the average family, and the above table shows that in only 2 years in the last 35 has the average worker received more than \$1,700 per year, or nearly \$300 less than a living wage. When our country was enjoying its most prosperous times, the average worker received nearly \$300 less than the amount required for a bare living per family. Let us compare the average in this table showing income and wealth of the average worker, as above shown, with that of the income and wealth of the average farmer. Dr. A. G. Black, Chief of Bureau of Agricultural Economics, submits the following tables showing agriculture's share of the national income and national wealth:

Farm income per capita and agricultural wealth of the United States, 1909-34

Year	Agriculture's share of national income		Agricultural wealth		Percentage agricultural wealth is of total
	Total	Per capita ¹	Total	Per capita	
	<i>Million dollars</i>	<i>Dollars</i>	<i>Billion dollars</i>	<i>Dollars</i>	<i>Percent²</i>
1909	4,988	156	41.3	1,291	19.6
1910	5,218	163	42.9	1,336	19.0
1911	4,815	150	44.1	1,374	18.7
1912	5,294	165	46.1	1,436	18.4
1913	5,133	160	47.7	1,486	18.2
1914	5,081	158	47.9	1,492	18.8
1915	5,488	171	50.5	1,573	18.1
1916	6,631	207	55.0	1,719	17.6
1917	9,188	288	61.6	1,931	17.1
1918	11,205	352	67.0	2,107	17.1
1919	12,182	384	79.1	2,495	18.2
1920	11,057	350	71.8	2,272	15.3
1921	6,967	220	63.1	1,991	14.6
1922	7,300	230	61.4	1,931	13.3
1923	8,026	256	58.9	1,882	12.1
1924	8,325	268	57.7	1,855	11.6
1925	9,089	292	57.8	1,859	10.8
1926	8,214	267	56.7	1,841	10.3
1927	8,371	276	57.2	1,888	10.2
1928	8,109	268	58.1	1,917	9.6
1929	8,254	272	58.1	1,917	9.3
1930	6,320	209	52.7	1,745	9.5
1931	4,659	152	45.3	1,480	9.6
1932	4,582	115	30.7	984	8.2
1933	4,557	142			
1934	5,287	163			

¹ Total of agriculture's share divided by farm population, Jan. 1.

² Agricultural wealth divided by farm population.

Senator Wheeler, in analyzing how completely big business is controlling the Nation, made the following statement in his speech on February 19, 1935, pages 2258, 2259 of the Congressional Record, based on information furnished by Berle and Means:

In 1930 there were over 300,000 nonfinancial corporations in the United States. Their gross assets were approximately \$165,000,000,000. Of these 300,000 corporations, the 200 largest, including 42 railroads, 52 public utilities,

and 106 industrials, each with assets over \$90,000,000, had combined assets of over \$81,000,000,000. These 200 corporations, representing less than seven one-hundredths of 1 percent of the number of corporations, thus control practically half of the corporate wealth of the country. Their control of the business wealth of the country, corporate and noncorporate, is equally impressive. It is estimated that at least 78 percent of American business wealth is corporate wealth. Since the 200 largest corporations control over 49 percent of all corporate wealth, it is estimated that they control over 38 percent of all business wealth. Likewise a substantial proportion of the total national wealth, corporate and noncorporate, business, agricultural, personal, and governmental, is controlled by these 200 largest corporations. Figures for 1930 indicate a total national wealth of about \$367,000,000,000. The \$81,000,000,000 controlled by these corporations represent about 22 percent of the total national wealth.

Even more significant than the present extent of concentration is its increasing rate; that is, the increase in the proportion of corporate business and national wealth controlled by the largest corporations. This rate of increase was greater for the years 1924-29 than for the years 1909-29; but if we take the period of slower growth 1909-29, and apply the same rate of growth for the next 20 years, we find that by 1950, 70 percent of all corporate activity would be carried on by 200 corporations. By 1950 half of the national wealth would be under the control of such corporations and by 1970 all corporate activity and practically all industrial activity would be absorbed by these 200 giant corporations. If we take the more rapid rate of growth, from 1924-29, and apply it to the future, we find that by 1950, 85 percent of the corporate wealth of the country would be held by these corporations, and by 1960 all corporate activity and practically all industrial activity would be in their control.

The existence of these giant corporations, of course, means enormous concentration of control in the hands of their individual managers. The 200 largest corporations are directed nominally by about 2,000 individuals out of a population of 130,000,000. These 2,000 individuals are those in a position to control and direct half of our corporate business. But actual control rests in the hands of even fewer individuals. Many of the 2,000 directors are inactive. The ultimate control, therefore, rests in the hands of a few hundred men. One further fact should be remembered. The foregoing figures are based on the direct control of assets by 200 nonbanking corporations. But the influence of each of these corporations, as is stated by Berle and Means, "extends far beyond the assets under its direct control." In short, the bulk of our corporate resources, the product of the savings and labor of millions of individuals rests in the control of a handful of men. These are the facts. It is the very negation of industrial democracy. It resembles, instead, a feudalism more pervasive than that of the Middle Ages.

Certainly with these facts staring us in the face no one will further contend or deny that the incomes of the rich are increasing and that the wealth of the Nation is rapidly and steadily under these depressed times being concentrated into the hands of the few.

These results are brought about by the successful operations of the lobbies of big business who have been instrumental in the enactment of special privileged laws over the past 60 years which have permitted them to bring about this chaotic condition. We can partially correct this situation by starting now to correct our system of taxation in keeping with the recommendations of the President by taxing wealth based upon its ability to pay. In order to make such a tax bill effective we must eliminate many of the exemptions and allowable reductions in existing law and strike out this of bill such wide open exemptions and allowed reductions as provided therein, if we are to realize any reasonable amount of taxes to be received during this emergency.

I requested an estimate of the Treasury Department as to the amount of revenue the amendments above suggested on personal income, estate, and gift tax would realize and on May 8, 1935, the

Department furnished me the following estimate of increases in revenue under these amendments:

Estimated increases in revenue

Individual income tax-----	\$234, 400, 000
Estate tax-----	127, 000, 000
Gift tax-----	14, 200, 000

From other information available I believe the above estimates are very conservative as to the increase in revenue under these amendments.

If the loopholes above suggested are eliminated from this bill and existing law, the revenues thus derived will more than double the amount now being collected.

PROPOSED AMENDMENTS TO STOP LOOPHOLES

The present gift-tax laws enacted to stop a decided loophole in the Federal estate-tax laws only partially stop the gap. Two changes are necessary to close the loophole:

1. Reduce the special exemption of gifts to any one person during any taxable year to \$500, the exemption allowed in 1924 law, instead of \$5,000 in the present law. The present law was adopted on amendment offered by ex-Senator David Reed of Pennsylvania.

2. Increase the gift-tax rates to make them equal in every respect to the estate-tax rates.

It may be argued that the estate- and gift-tax laws should encourage the aged to give away their property before death. With the changes I have proposed there will still remain inducement to give away property before death, for even these rates permit substantial savings if portions of property are distributed before death.

In addition to the above-suggested amendments, I submit for the committee's consideration the following proposed amendments as being sound, wholesome amendments that should be made to our tax laws:

1. Effective for any taxable year ending subsequent to the enactment of this act, the Revenue Act of 1934 is amended by adding a new section as follows:

"SEC. 169. Transfers to evade taxation. (a) Gifts of husband and wife: Where a husband transfers property by gift to his wife, or vice versa, and the husband and wife are living together, or, if separated, there has been no final settlement of their property rights, then the income derived from such property (and from property substituted therefor) shall be included in computing the net income of the spouse who made the transfer as if such transfer had not been made. (b) Family trust: (1) Where the husband or wife of the creator of a trust is a beneficiary of the trust and the husband and wife are living together or if separated, there has been no final settlement of their property rights, or (2) where a child or a parent of the creator of the trust is a beneficiary of the trust and under the laws of descent an interest in the corpus of the trust or in the income accumulated for or distributed to the child or parent, as the case may be, may be vested in the creator of the trust, then that part of the income of the trust accumulated for, or distributable to, the husband or wife or child or parent of the creator of trust shall be included in computing the net income of the creator of the trust.

2. Effective for any taxable year ending subsequent to the enactment of this act, section 22 of the Revenue Act of 1934 is amended by adding at the end thereof a new paragraph, as follows:

(g) Undivided profits of corporations: Any portion of the net income of a corporation subject to the tax imposed by section 13 (a) of this act remaining undistributed at the close of its taxable year shall be accounted for by the stockholders of such corporation at the close of its taxable year in proportion to their respective shares. Within 45 days after the close of its taxable year and in accordance with rules and regulations prescribed by the Commissioner, with the approval of the Secretary, the corporation shall file a return showing the number of shares held by each stockholder and the amount of undivided net income allocable to each share and shall report to each stockholder the amount of undivided net income allocable to each share.

3. Effective for any taxable year ending subsequent to the enactment of this act, the Revenue Act of 1934 is amended by adding a new section, as follows:

Sec. 151. Disclosure of income not reported as taxable. Every person subject to the tax imposed by this title shall file with the collector a statement for each taxable year showing (1) all income for the year not reported on the income-tax return for the year, (2) all distributions from corporations received within the year and not reported on the income tax for the year, and (3) all sales and exchanges of property other than property held primarily for sale in the course of a trade or business and other than sales and exchanges reported on the income-tax return for the year. Such statement shall be in accordance with rules and regulations prescribed by the Commissioner and approved by the Secretary, shall be filed on or before the 15th day of the third month following the close of the taxable year, and shall be duly verified under oath.

4. Effective upon the enactment of this act, section 501 (a) of the Revenue Act of 1932 is amended to read as follows:

(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift or by bequest, devise, or other testamentary disposition. The terms "gift", "gifts", or "net gifts" as used in this title include gifts inter vivos and testamentary gifts and dispositions.

5. Board of tax appeals: The present Board of Tax Appeals was created in order to provide an independent review of the taxpayers' cases before assessment of deficiencies. The Bureau by reason of inadequate personnel and incompetent administration imposed ill-considered and unreasonable assessments on taxpayers. Congress sought to stop this by providing an independent review body in the Treasury Department. Unfortunately, however, the members soon surrounded their review by the rules adopted by the equity courts of the District of Columbia. This turned what was intended to be a review body into a highly technical court, before which a taxpayer is forced to employ a specially trained lawyer and provide himself with expensive witnesses in order to be given the consideration which was intended without this great expense. In looking over the results of this body I find their rulings are so inconsistent that Bureau officials cannot be consistent in administration because of these inconsistencies. These decisions have laid the ground work and have been the cause of a flood of litigation equaled in no other country. Administration of our taxing laws is a practical matter. The courts have held that these statutes should be construed liberally in favor

of the taxpayer. I see no reason why an administrative problem of arriving at the correct tax should be turned into such a mass of litigation as has resulted from the creation of the Board.

I, therefore, recommend that you give consideration to abolishing this body. In its stead you should create an independent review body composed not of lawyers only, but of practical tax men such as auditors, and engineers. Provide that this body shall function purely as a review body and without the technical requirements of a court. Provision could be made for taking testimony when a case was appealed so that the Board's findings will be given the same status as the findings of commissioners of the Court of Claims.

The creation of such a body I regard as the first step in simplification and one of the most important ones. I, therefore, urge its consideration. The following amendment gives effect to my views on this subject.

Tax Adjustment Board.—(a) There is hereby created in the Department of Treasury a board to be known as the "Tax Adjustment Board" (hereinafter referred to as the "Board"). The Board shall be composed of nine members. Each member shall be appointed by the President, by and with the advice and consent of the Senate, for a term of 6 years, and shall receive compensation at the rate of \$9,000 per annum. The Board shall at least annually designate a member to act as chairman. The Board shall have the powers, duties, and functions described in this section and in section 6 and shall have the power to prescribe rules and regulations governing all appeals filed with it.

(b) Upon receipt of a notice of deficiency in income tax, estate tax, inheritance tax, or gift tax sent to the taxpayer in the manner provided by the Revenue Act of 1924 and subsequent acts, the taxpayer may, within 90 days, or within 90 days after the enactment of this act, whichever is the latest, file a notice of appeal with the Board. Such notice shall be in the form prescribed by the rules of the Board. Within the time provided by the rules of the Board, the taxpayer shall file a statement of all facts and reasons and such documents and papers, or verified copies thereof, which he intends to submit in support of the appeal, and shall by registered mail, send to the Commissioner a copy of all such statements, reasons, documents, and papers. Thereafter the Commissioner, if he desires to proceed further, shall file with the Board a copy of the income-tax return, a statement of the facts and reasons and documents relied upon by him and shall send a copy thereof to the taxpayer by registered mail.

(c) The Board shall have the function, power, and duty to hear such appeal and to review, adjust, and determine the tax liability in controversy. All proceedings before the Board shall be in accordance with rules prescribed by it: *Provided, however*, That all hearings shall be open to the public and all records, documents, and papers filed in any proceeding shall be open to public inspection.

(d) The Board shall notify the taxpayer of its decision by registered mail and send a copy thereof to the Commissioner. If dissatisfied with such decision, the taxpayer or the Commissioner may, within 60 days, file with the Board a notice of dissatisfaction. Such notice shall be in the form prescribed by the Board.

(e) Within 60 days from the filing of the notice of dissatisfaction, the Board shall transmit to the clerk of the United States District Court for the district in which it is located the collector's office to which was made the return of the tax in controversy, typewritten copies of the notice of dissatisfaction and of all statements, documents, and papers on file before the Board and relative to the notice of dissatisfaction. The matter shall thereupon be deemed to be an action in the said court ready for trial or hearing: *Provided, however*, That should it be deemed advisable by the court or a judge thereof that pleadings be filed, an order may issue directing the parties to file pleadings.

(f) A taxpayer who files a notice of dissatisfaction shall give bond, in a sum fixed by the Board not exceeding double the deficiency determined by the Board, and shall give security for the costs of the appeal to the district. Failure to file such bond and give such security shall render the notice of dissatisfaction and all proceedings thereunder null and void.

6. Board of tax appeals abolished: Effective upon the ninetieth day following the enactment of this act, the Board of Tax Appeals established by section 900 of the Revenue Act of 1924 and section 1000 of the Revenue Act of 1926 is hereby abolished. No petition shall be filed with the Board of Tax Appeals with respect to any deficiency determined subsequent to the enactment of this act. All proceedings pending before such Board on the sixtieth day following the enactment of this act are hereby transferred to the Tax Adjustment Board and all the powers, duties, and functions of the Board of Tax Appeals are hereby transferred to the Tax Adjustment Board for the disposition of such pending proceedings. After the Tax Adjustment Board has entered its decision in such pending proceedings, petitions for review may be filed in accordance with sections 1001, 1002, 1003, 1004, and 1005 of the Revenue Act of 1926. The provisions of this section shall not affect any proceeding pending before any appellate court reviewing the action of the Board of Tax Appeals.

In conclusion let me thank the committee for their courteous consideration and let me again express the hope that the committee will give careful consideration to the above suggested amendments to the existing revenue law, including the amendments offered for the purpose of stopping some of the loopholes and exemptions now existing in the law.

(Further statement is as follows:)

JULY 31, 1935.

RE CONGRESSMAN M'FARLANE'S TAX AMENDMENTS

To the Chairman and members of the Senate Finance Committee:

In submitting this statement, I have no desire to attack the new tax rates and taxes proposed in H. R. 8974. They are clearly imposed upon persons who have received benefits under our Government greatly in excess of any tax imposed. Those taxed are able to pay. They are the ones to whom we have looked for economic improvement, but they have clearly shifted the burden to the Government to carry all the load of every effort which does not assure them their desired profit. In no other country in the world have men had such an opportunity to accumulate income and wealth. Yet those most benefited fired millions of men and disclaim all obligation or duty to the men who helped them. Reserves and surplus for dividends but not one extra cent for the Government which lends a helping hand to the unemployed. That is their motto. It is unsound.

However, we must admit that the new tax rates, like the present ones, will be greatly ineffective unless the easy methods for escaping tax are removed. There is nothing new in the tricks available. They have been used for years by everyone except the small taxpayer solely dependent upon a salary income. We know they exist. And today the most unfortunate state of mind on the part of the public in general is the scepticism engendered by repeated instances of escape. For this reason, it is submitted that the plan of correction submitted by Congressman McFarlane in his statement to this committee should be adopted. (See Hearings, pp. 330-340).

Family gifts.—The provisions in Congressman McFarlane's suggested amendments relating to family gifts propose to ignore gifts from one spouse to the other and trusts created for the benefit of the one spouse and the minor children. This eliminates the easiest device by which a taxpayer may split his income and keep out of the high-tax brackets by creating as many separate taxable units as there are members of the family.

It is no answer to reply that there is a tax on gifts, for by paying a gift tax the taxpayer may secure a lower rate of income tax for the rest of his life. The tax on gifts does not take away this advantage. The gift tax is merely a smaller premium for a large tax exemption which permits the high income-tax rates to

be little more than a joke to any one who wishes to escape. An article by Paul R. Leach in the Chicago Daily News, July 5, 1935, clearly shows the opportunity which exists to anticipate the new tax bill and avoid its purpose.

Undistributed profits of corporations.—Congressman McFarlane's method of taxing the annual corporate profits to the stockholders, whether distributed or not, was followed in the income-tax law enacted during Lincoln's administration and was upheld by the Supreme Court in *Brainard v. Hubbard* (12 Wall. 1). It is needed now.

We have been notably lax in permitting stockholders to leave their profits in the corporation and thus evade surtax. The law enacted to prevent this cannot be successfully enforced because it is based upon motive, or the manner in which the income was earned. Surplus is ploughed back into the business year after year with no substantial tax upon the stockholders, particularly in the case of the closely held corporations. They are not entitled to this exemption. The annual increase in wealth should be taxed to the stockholders regardless of how it was earned or how it is invested. With this premise, we see that Congressman McFarlane's plan has many advantages:

1. The ability of each stockholder to pay taxes would be more properly and justly measured, without the present discrimination against certain stockholders on account of the manner in which the corporation earned its profits.

2. Stockholders could not so advantageously obtain corporate funds for their personal use without paying a tax, as is done at the present time where the funds are taken out of the corporation by way of loans instead of taxable dividends.

3. It would eliminate the difficulty existing at the present time in regard to stock purchased between dividend dates.

4. A purchase of assets by the stockholder from the corporation at a price substantially less than their fair market value could not be so successfully used as a device for distributing funds without tax to the stockholders.

5. Distributions of dividends in the guise of a partial liquidation dividend would be of no tax benefit, whereas at the present time it is a convenient means of escape without any certain plan of prevention.

6. In other words, evasion of surtax where corporate profits are left in the corporation would not exist.

Reporting income and transactions claimed to be nontaxable.—Taxpayers who wish to hide income by not reporting it do not do it crudely. First, there must be a scheme setting up some pretended claim that it is not taxable. With this in his file, the taxpayer omits the income and is not subjected to a penalty even if he is caught. Congressman McFarlane's plan makes the taxpayer disclose all and gives the Government an opportunity to check the claim, allow it if it is proper, and assert an additional tax if it is not proper. Failure to disclose would subject the taxpayer to a penalty and no one wants to face the prospects of a penalty.

This permits the Government to make an orderly and systematic check of all items, whereas at the present time the auditors must chase up all the blind alleys and be snoopers to find these undisclosed transactions. This provision is very badly needed.

Gift tax.—Under the present law, as well as the preceding ones, the amount of estate tax payable can be materially reduced if the decedent disposes of a substantial portion of his estate during his lifetime. Two correctives are now employed—one is the gift tax and the other is the provision in the estate which taxes gifts made in contemplation of death. Thus only the latter gifts are included in measuring the estate tax liability and to include them requires administrative action determining that the gifts were made in contemplation of death. This involves difficulties in administration and has been accomplished rather haphazardly. The gift tax is an attempt to overcome this handicap, but it has gone only part of the way. Large tax savings can still be effected by gifts during lifetime. The new tax bill does not stop this but on the contrary makes it more desirable for taxpayers to resort to this means of escape.

The obvious solution lies in eliminating all distinction as to whether a gift is made prior to death, or in contemplation of death, or at death. By what reasoning have we concluded that a man's duty to pay taxes, or his ability to pay, is unusually related to his thoughts of death? What does it matter when he gives away his property? Obviously no material distinction can be made. Instead of having an estate tax and a gift tax, there should be one tax, with one schedule of rates and as each succeeding gift is made it should be placed in the next higher rate bracket

and taxed accordingly. This method is now followed under the gift-tax law but it only includes gifts *inter vivos*. It should be extended to include gifts, bequests, and devises under one tax. Congressman McFarlane's amendment does this. Under this plan a person might dispose of his estate at any time and in any manner he might choose, paying a tax as each gift is made, and the total tax upon all the transfers would be the same, regardless of when made or what the donor's motive was.

Board of Tax Appeals abolished.—The work of the Board of Tax Appeals is open to criticism upon the following grounds:

1. By its technical construction and application of the law in a manner clearly contrary to the intent of Congress, it has set up rules for determining when to report income and take deductions, which cannot be understood and applied with any degree of certainty by experts, much less by taxpayers.

2. By reason of this superficiality, income at times completely escapes tax when it should be taxed once to the person who received it, and by the same legalistic philosophy income is at times taxed twice to the same taxpayer. Similarly, deductions are sometimes allowed twice or not at all. This condition exists because of the Board's decisions regarding the time to report income and take deductions.

3. The Board's technical decisions give support to the many devices used to escape tax. Many of the devices not referred to above exist solely by reason of technicalities. Formal acts which have little or no significance in business or law are made the predominant factors in fixing tax liability. The Board says formal acts are to be given substantive effect (27 B. T. A. 337). Consequently, those who scheme to evade are upheld in matters of form. Those who are ignorant of the significance of form and superficiality often find themselves unexpectedly and improperly taxed.

4. These strained and superficial constructions of the Board take time. The Board is often hard put to uphold them. Lengthy decisions follow. The result is that there is always a large number of pending cases with millions of dollars stayed from collection. When this matter was last brought into the open, the Board proceeded to hold many hearings but it took as high as 15 and 20 months for them to give their decisions in many of the simple cases. The result is that taxes 10 and 12 years old are pending before the Board for no reason except that they have not been disposed of by the Board.

5. Under the present procedure all time and effort to settle a case in the Department is lost when the case goes to the Board. There we start anew, with nothing except a petition. Papers, documents, briefs, and facts filed with the Treasury do not go before the Board. Everything must be done all over again—a most absurd waste of time and energy but an excellent way to prolong the payment of the tax.

The Tax Adjustment Board proposed by Congressman McFarlane will permit a more prompt and reasonable settlement of tax cases without a duplication of effort. It consists of a smaller number of members. This is proper only if his other amendments are enacted. This country surpasses all others in tax litigation. The Board of Tax Appeals and the devices for escape are responsible for this. Eliminate these and nine members are sufficient for the Tax Adjustment Board.

In conclusion, it is submitted that since these conditions have existed for years, it is time for definite action to be taken to eliminate them. At the last session of Congress the House passed a resolution creating a subcommittee to investigate the entire subject and to formulate plans for "preventing evasion and avoidance" of the tax laws. This subcommittee rendered its report on a study of the English system after a group made a trip to England for that purpose. Others have studied the same problem and it is apparent that Congressman McFarlane has done the same thing, for his proposed amendments are rated the best piece of tax legislation on the subject offered to Congress within the past 20 years. It is submitted that unless something better is offered the McFarlane amendments should be passed. We should not permit the heart of the President's tax program to be eaten out by tax-dodgers.

Respectfully submitted.

HERMAN T. REILING.

Senator KING. Thank you very much, Congressman. We will hear Mr. McNair, mayor of Pittsburgh.

STATEMENT OF WILLIAM McNAIR, MAYOR OF PITTSBURGH, PA.

Mr. McNAIR. Gentlemen, I represent the city of Pittsburgh, and after listening to Mr. Jackson this morning, I must confess he got me a little tangled up with a lot of this technical business, but there are a few features I would like to suggest.

We object, in our city, to this new tax bill, because it will take so much money out of Pittsburgh. Now, the Federal Government the last year took about \$79,000,000 out of our town, and I got none of that back.

As far as I am concerned, as the mayor of Pittsburgh, I think it is too big a burden, the people there cannot pay their local taxes. We have got to furnish police protection, fire protection, water, sewage disposal, and garbage disposal, and such things, and if the Federal Government takes our money away from us, and the city government takes half of what is left, where are we going to get the money?

You took \$79,000,000 out of our town last year, and you will take twice that much if you pass this legislation, so I have come here today to protest to this committee on behalf of the city of Pittsburgh, that we cannot stand this any longer.

Years ago we had another thing like this, we had a whisky rebellion. Why? Because the people would not stand for it. I will not say anything like that will happen again, but it is too much. I think the Government ought to have a little mercy on us.

I went over to Mr. Ickes today, and I know you are spending some of the money, but in a way we do not like. You are putting tolls on every bridge to our city right now.

Senator GORE. Why is that?

Mr. McNAIR. You are putting tolls on every bridge and tunnel to our city, and how are we going to do business if the people are stopped from coming there? I was over in Wheeling and other places, and they say they will not come to our city if they have to pay tolls. You say if we do not put tolls on these bridges and tunnels, you will not give us more money for new projects and new improvements and so we have got to put tolls on all of the existing roads and tunnels to our city.

Senator WALSH. That must be private property.

Mr. McNAIR. It is not, Senator. That Liberty Bridge was built by the Government, and they say they will not give us any more money unless we pay tolls on the old projects.

Senator GORE. We people in Washington know more about what you need in Pittsburgh than you do.

Mr. McNAIR. But you are not sitting on the spot like I am. I have got to give the city police protection, and if you pass this bill and the Federal Government gets the money, there is none left. How am I going to do it, and then if you come in and charge tolls, that takes a lot more money out of the community.

Senator KING. Think of the available printing presses.

Mr. McNAIR. How do you mean?

Senator KING. We can print a lot more money.

Mr. McNAIR. Yes, Germany did that, and see where they landed. I would like to see the power of printing money taken from the Federal Government, because look where it is getting us.

I was a delegate to the Chicago convention, and I voted for a platform to balance the Budget. I hope we will do it, but what are you doing down here in Washington now?

Senator KING. We are unbalancing it.

Mr. McNAIR. We hope you will balance it, because you are destroying the reservoir of credit in this country. There is no reservoir of credit left, and there is no money to do business with.

This gentlemen that spoke just before me—I think he was talking about Pittsburgh, and I wanted to answer him and tell him that those banks in Pittsburgh did not shut down when the rest did, and I had my money in there, too. Bigness is not any harm. The corporations around Pittsburgh are big, but you have got to have big corporations and big business, and I am a Democrat, too.

Senator GORE. You are what?

Mr. McNAIR. I am a Democrat.

Senator GORE. What is that?

Mr. McNAIR. Well, that is a party founded in Pennsylvania by Benjamin Franklin. You think it was formed by Thomas Jefferson, but it was not. It was formed by Benjamin Franklin, and it is founded on free trade. That is what will get you out of the depression—free trade.

Senator GORE. Daniel comes to judgment.

Mr. McNAIR. My name is William. What is going to happen to Pittsburgh if you pass this bill? You are not going to reduce wealth, you are going to take it out of Pittsburgh, and we will not get it back. There is no redistribution there, that is fictitious.

I have been a lawyer for 30 years, and know a little about the Constitution, and I want to say to you I believe this bill violates the provisions of the Constitution, in that it takes away property from us in Pittsburgh without compensation.

What do we get back for it? When I levy taxes in Pittsburgh, the people get good police protection, because we have not had a major crime since I have been mayor, because we took the police out of politics. The people get water, sewage and garbage disposal. The Democrats are not giving very many jobs, and that is the reason they want to rip me out of office. I am still there and I am going to run for County Commissioner to stop this toll business.

If the Federal Government takes this money away from us what do we get back? When I levy taxes in Pittsburgh, we give them something. What do you give us, I would like to know? If you don't give us anything, you are taking money without compensation, and that is against the Constitution.

Senator KING. We have given you more than a million Federal employees.

Mr. McNAIR. Yes; but I didn't name any of them, I will tell you that.

Senator WALSH. I hope the Pittsburgh press is represented here.

Mr. McNAIR. They don't print anything I say. However, my suggestion to the committee, in all sincerity, is this, that as to the industry in Pittsburgh, it is true we have great corporations, but at least they give you some jobs, and I believe that taxes on industry of

any kind are bound to destroy the industry. The great estates, the great incomes, are all created by some privilege given by the Government.

We would not have our big corporations, our big incomes in Pittsburgh, if it were not for the tariffs. I don't know whether Senator La Follette will agree to that, but you come to Pittsburgh and examine any big estate, and that big estate is founded on the tariff. Isn't that right, Senator La Follette?

Senator LA FOLLETTE. Partly.

Mr. McNAIR. Lowering the tariff would make a difference, and you would not have the big estates and the big incomes.

Senator GORE. What do you suggest?

Mr. McNAIR. You say take the money away from the big fellows, but my idea is don't give it to them in the first place, by lowering the tariff. That is just from a little fellow in Pittsburgh, but I am on the spot there. I have thought this out, and that is the conclusion I have come to.

You might be surprised to hear anybody from Pittsburgh talking about free trade, but a lot of us would like to see the tariffs wiped out. Then you would not have these big incomes, to redistribute. Do just like we are in Pittsburgh. We are abolishing all of our income taxes; we don't have income taxes and taxes on goods and machinery; we abolished all of the taxes. We also give you a half rate on the house, when you build it. If you do this, you will open up opportunities for people to employ themselves, or to employ others, and until these taxing bodies stop destroying industry by taxes, or trade exemptions like the tariff, and with income taxes like this, and get down to something that is fundamentally right and economically right, and take the public revenue created by the public, you will not get out of the depression.

Senator GORE. You put a low rate on improvements.

Mr. McNAIR. Yes; \$10 on the house and \$10 on the lot.

Thank you gentlemen very much. If you have any questions to ask, I may not answer to your satisfaction, but I will answer them to mine.

Senator GORE. Couldn't we arrange for you to run for President in 1940?

Mr. McNAIR. No; I will run next time. Why not? We need a Democrat on the ticket, for a fellow like me to vote. What I think is that we have got a lot of communism down here now. That is what this administration is, to be frank. What democratic principles are you putting into effect here? Redistribute the wealth; what is that? It is not democracy; it is communism.

Thank you.

Senator KING. Thank you, Mr. McNair. We will now hear Mr. Clausen.

**STATEMENT OF FRED H. CLAUSEN, HORICON, WIS., CHAIRMAN
OF THE COMMITTEE ON FEDERAL FINANCE, UNITED STATES
CHAMBER OF COMMERCE**

Mr. CLAUSEN. Mr. Chairman and gentlemen, I am appearing here as chairman of the committee on Federal finance, United States Chamber of Commerce. In the statement I desire to submit, I will

present certain proposals, and we have three other members of our committee who will appear in this group to handle various other items of the proposals contained in the House bill, Mr. Alvord, on the excess profits, Mr. Osgood on inheritance, and Professor Fairchild, of Yale, will discuss the economic factors of the proposals.

Senator GORE. Are they here?

Mr. CLAUSEN. They are here, yes; and that is why we appreciate your treatment and attention in the hearing.

My presentation is based on the background of a business man, and I will try to give you the view, I think, of the vast majority of the business men of the country toward tax proposals which are now before you.

We appeared before the Ways and Means Committee of the House, but at that time had no proposals before us. This time we have the House bill before us, and we are directing our argument and statements to it.

This, of course, is a little embarrassing to us, in view of the statement made by the representative of the Treasury Department, but we will take this occasion to indicate some of our thoughts with reference to some of the thoughts he adheres to.

Senator GORE. I did not understand the name you gave as to a statement made by somebody.

Mr. CLAUSEN. The representative of the Treasury Department, Mr. Jackson.

We are excluding testimony upon what we believe to be inequities and needless difficulties for taxpayers in our existing internal revenue laws and their administration.

There is no firm determination as to the amount of increased revenues to be sought. There is no intimation as to the expenditure or budget policy for the next fiscal year (1937). There have been only a few days' notice of the ranges of rates and yields, and of the administrative provisions which require time for thorough examination, but which in a number of respects contain apparent weaknesses.

Even though we assume that your committee is here mainly interested in taxes for revenue purposes, we labor under uncertainty as to whether the suggestions that have been advanced will be considered by both Houses principally from the standpoint of revenue policy or from the standpoint of certain social theories, or, if the view be taken that there are mixed motives, then the proportionate weight to be given to revenue considerations in contrast to other viewpoints. With these uncertainties, like your committee and the Congress, we have the additional difficulty of haste near the end of a laborious session which has passed and is to pass laws which have a direct effect upon revenues and upon the ability of taxpayers to meet the Government's levies. Opportunity to digest the economic and financial effects of these laws and their bearing upon Government revenues and taxpayers' ability has not been afforded.

We approach your committee, therefore, in circumstances very different from those in which most other revenue measures have been framed and expressions of opinion offered. We deplore these circumstances because of the difficulties involved for all parties, when the endeavor is hurriedly to decide upon desirable policy. We deplore them also because we know that business is fearful of the effects that such a measure will have upon the ability of our citizens—those in and

out of public office—to reach our major objective, namely, the creation of conditions conducive to the greater application of private resources and energies in order to obtain economic recovery.

We are assuming that it is the preponderant purpose of the proposals or, at any rate, that it is the intention of Congress, to seek additional revenues “without”, as the President says, “discouraging enterprise.”

We think this main objective should be first in the minds of those who have proposals that affect that in any way. That is the point of view that we are trying to take in the discussion of this tax proposal which came upon us so suddenly—that it is the intention of Congress to seek additional revenues without discouraging enterprise, without confiscation and without going in the opposite direction to the objectives that should be sought.

If that be a correct assumption, than the proposals in the House bill relating to a corporation income tax, to a steeply graded excess profits tax, and to an inheritance tax which, because of rates and other provisions, may prove in practice to be tantamount to confiscation, are, in our judgment, highly discouraging to enterprise.

At the same time we do not wish to be understood as taking the position that new taxes, or such revision of rates as will really aid Government revenues and are well conceived with attention to balancing a Budget of proper scope, will be inadvisable at a later date. We do take the position that in the general economic interest the provisions of the House bill, under all existing circumstances, should not be enacted now and some of them should at no time be enacted.

In other words, when you take up a fiscal problem of this kind, having to do with its ramifications and impact upon business, it should be a complete program, having in mind, as a business organization would consider it, the need for a balanced Budget, and for a limitation in some way as to the expenditures of the Government, and the required revenues obtained from the proper sources to meet those expenses, so that the affairs of our Government, like a good business organization, will be put in order.

Now, I want to deal with two subjects in my discussion; first, the individual income tax, and second, the proposal for a graduated corporation tax on business.

We do not accept the estimate of \$270,000,000 as the yield from the taxes in the House bill as a realistic one for reasons which will be developed later. But if \$270,000,000, more or less, additional revenue be sought as the objective, it is obvious that the gap between receipts and expenditures could be narrowed by such an amount more quickly, with less economic injury, if the Government cut that amount from its expenditures.

It is also obvious that reduction of expenditures must be faced. If, in reply, it be stated, that when some reduction is made in the scale of Government expenditures, there still will be need for additional taxes, we call attention to the fact that what the country now needs is more income that may be taxed, not taxes that present the danger of driving wealth and income into the ground or into avenues of escape from taxation.

In some circles it has often been announced that the budget cannot be balanced until there is greater business recovery. If that be a correct thesis it can as well be said that a budget balance should be attained through maintenance of present rates of income taxes,

while awaiting the larger national income and Government receipts that will accompany greater business activity.

We will present some data later showing the extent to which the yields from income taxes decreased by reason of the shrinkage of taxable income and also demonstrate that some broadening of the tax base from increase in taxable income is now being experienced.

I shall now deal directly with proposals in the House bill (sec. 101) for some increases in the surtaxes upon individual incomes.

A basic principle underlying individual income taxation is that high rates do not in themselves produce large revenues.

This country's relatively short experience with income taxation affords adequate evidence of this. The 1928 Revenue Act was the most moderate since the war. The maximum surtax rate was 20 percent, applicable to the \$100,000 bracket. Personal exemptions were high—\$1,500 for a single person and \$3,500 for a married person. There was a relatively generous allowance for earned income and the definition of taxable income was reasonable. In that year the personal income tax yielded the highest amount in peace-time history—\$1,164,000,000. In 1932 the income tax yielded but \$328,000,000, a shrinkage of almost three-fourths. In other words, that is a shrinkage in those 2 years of several times more than what is supposed to be raised by higher rates included in the House bill. Since there had been no alteration in rates in the years mentioned, these figures indicate the small effect which rates have on revenues as contrasted with the base of such taxes.

It is the amount of taxable income and not the rates that determine revenues. Efforts should be turned to devising ways and means of increasing taxable income, rather than to developing higher tax rates applicable to a shrunken national income which under the impacts of the proposed taxes may shrink still more.

I could not help but be impressed by the position taken by the representative of the Treasury Department, that he is looking at the proposition from the standpoint of the collector of taxes. We are viewing it from the standpoint of the payer of taxes. I think it is very important to have that difference in mind. It is not a question of the ease of collection, but it is a question as to the proper and fair way of collection.

Furthermore, it must be recollected that a very substantial portion of the revenues from the individual income tax is derived from capital gains. Generally speaking, such gains are realized only when capital assets are sold. Under ordinary circumstances, no individual will sell a capital asset if but a small percentage of his profit will be available to him after the payment of taxes.

The proposed surtax schedule would increase taxes on all incomes above \$50,000. The effective rate on an income of \$100,000 would be 34 percent; on \$150,000, over 43 percent; on \$250,000, 52 percent; on \$500,000, 61 percent; on \$750,000, 65 percent; on \$1,000,000, 68 percent; and on incomes of \$5,000,000, 76 percent. On the higher incomes these rates cease to be taxation and become confiscation. The rates alone justify this statement. Beyond the rates, however, we have also in mind other provisions of the law, such as those affecting the character of the income included in the determination of taxable income.

According to preliminary returns in 1933, the number of taxpayers affected by the proposed increase—that is, those reporting incomes of \$50,000 or over—numbered 7,974; in 1932, the number was 7,738; in 1931, 11,014. Singling out from the entire population a few thousand for excessive and discriminatory taxation becomes in effect a form of class legislation. It is an impossibility to assume that these effects in practice will be limited to the few directly affected.

These surtax proposals, like the proposals to increase substantially the Federal death dues, are opposed by our committee, and, in our judgment, should be opposed by small and large business interests—not by reason of the direct effect of the suggested taxes upon the few or the many, but (aside from questions of elemental justice to the individual) because of the effects upon present and future business operations.

It is difficult to understand, and more difficult to justify, the urge to punish size, merely because of size, without regard to other factors. Rather it should be a matter of pride that this country has sufficient natural resources and enough genius and energy among its individual citizens to build up large incomes.

Every individual who has built up a sizeable income must inevitably in the process pay wages and salaries to a large number of others, either directly or indirectly. The history of this country affords an abundance of examples of this. Two great railroad builders not only gave employment to thousands during their lifetime, but made possible the development of whole new empires which today are contributing liberally to the wealth of the country. Another great industrialist developed a vast new industry which ranks among the largest in the country. Another revolutionized transportation and has given employment at one time to 200,000 people directly, and a greater number indirectly. Other examples could be given. Discouraging the full utilization of the ability of men of this character means less employment for wage earners and salaried people.

Any business enterprise has its attendant risks. New projects are highly speculative, and only those of substantial means are justified in launching them. Prospective profits must be in proportion to the risks or new enterprises will not be started. When the taxpayer knows in advance that the Government will take from two-thirds to three-fourths of any profits that he may make, the incentive to undertake the risks and responsibilities of an active business is seriously diminished or completely destroyed. Rather he will prefer to become passive in the business world. Investment in tax-exempt securities offers an attractive refuge.

The proposal to abolish tax exemption upon future issues of securities is not overlooked. The chamber formally approved the abolition of such tax exemption as long ago 1921 and at various times since has reaffirmed this position. If Congress should pass a constitutional amendment looking to the future elimination of tax-exempt securities, the ratification of 36 States would be necessary before it could become effective. It has always been rather doubtful whether the requisite number of States would ratify.

A new situation is now arising which makes the outlook still more dubious. Under the social-security legislation, now pending before Congress, the Government would be required to lay up large reserves

to be accumulated in Government securities. To the extent that the Federal issues are purchased for the security fund the States would be deprived of opportunity of taxing them. This would be additional reason for hesitation on their part in the matter of ratifying the proposed reciprocal constitutional amendment.

At the present time there are outstanding about 50 billion dollars of obligations wholly or partially tax exempt. Of this amount 18 billion dollars is in State and local securities which are entirely exempt from Federal income taxes.

It can be conceded that the amount of tax-exempt securities now existing or likely to exist in the immediate future is not sufficient to absorb all capital available for investment. Even if it were sufficient, it can be conceded also that all capital would not or could not be placed in tax-exempt securities. The point here, however, is that the capital of individuals with large incomes, say, those whose incomes would be subjected to the surtaxes of 50 percent or more, could to a very considerable extent, if not entirely, be invested in tax-exempts to the betterment of the income position of these individuals.

In 1933 there were only about 2,000 individual returns showing net income of \$100,000 or more. Less than 1,000 of these had income in excess of \$150,000. This thousand reported net taxable income of about \$334,000,000, of which about \$227,000,000 was received from taxable interest and dividends subject to the surtax.

It is to be noted that in the past 4 years State and municipal issues, exclusive of refunding, averaged about \$830,000,000 annually. Even if no allowance be made for Federal issues which are wholly or partially exempt, and which at present offer an additional refuge from excessive taxation, the volume of State and municipal issues alone will furnish a very considerable haven of refuge from excessive Federal taxes upon large incomes.

It is the individual with substantial income who must be relied upon to assume the risks of new projects and to furnish the money for increase of capital of established enterprises. If such individuals be driven to legal avenues of avoidance of high taxes, business and employment must suffer and in the end the Government revenues.

A simple illustration will demonstrate the attractiveness of tax-exempt investment to those who otherwise would have to pay the proposed surtaxes. Assume that a taxpayer contemplates investing in some legitimate but new project, with large attendant risks but with reasonable prospect of success, and believes that he has a fair chance of a substantial profit of \$250,000. He happens to have an income of \$500,000 from other sources. He is likely to consider that if he made a profit of \$250,000 the taxes would take 75 percent of it. Under these circumstances a tax-exempt security with an interest of 3½ percent would yield as much net income to this taxpayer as 15-percent profit on an investment the income from which was taxable.

The last arguments made as to the proposition of the flight of capital into tax-exempt securities has been made before, but we simply want to include it here to indicate at this time the position of the chamber upon it.

The amount of revenues from the increased personal income tax is estimated at 45 million dollars. In the face of 3½ or 4 billion dollars annual deficits, this amount is minute. It would barely equal the amount of customs and internal-revenue taxes illegally collected and

refunded in the fiscal year 1935. If processing taxes were included, the increased revenues would fall short of tax refunds during the year just closed by 30 million dollars.

It is doubtful, however, if the proposed revenues would yield the estimated 45 million dollars. Incentive to buy tax-exempts by those of large incomes who pay the high surtaxes and whose taxes it is proposed to increase; the proposed increase in the corporation income rate, including excess profits, would decrease the income of individual taxpayers, especially those in the higher brackets; the lessened incentive of those of large incomes to engage in productive enterprises; the impetus which will be given to find legal means of avoidance; the emigration of individuals taking their taxable income with them—all these throw doubt on the amount of revenues which might be obtained from the proposed increases in personal income taxes.

The country is now slowly emerging from the depression, but there are many people on relief rolls. Every encouragement should be given to those of means and ability to apply their resources to productive business enterprises. The proposed increase in taxes on individual incomes cannot give that encouragement. The Congress must choose—and most serious consideration should be given to the matter before the choice is made.

The effect of high rates upon the administration of tax laws should not be overlooked. It is generally agreed that the definition of taxable net income is arbitrary, and that the accurate computation of income-tax liabilities is an extremely complicated, and at times nearly impossible, task. Under reasonable rates, the inequities of the revenue laws do not strike so severely, and errors of law and fact in the computation of tax liabilities are not so costly; consequently, tax liabilities are settled without serious controversy.

If however, the rates are increased substantially, inequities become harsh and unbearable, and any errors in computation may involve tremendous sums. The difficulties always present in the administration of the law are markedly enhanced. Prompt and final determinations—to which every taxpayer is entitled—are unattainable, for an otherwise competent staff soon fears to accept responsibility for decisions. Tax controversies get into the courts with consequent delays, uncertainties and costs.

I wish to develop briefly some aspects of the provisions in the House bill (secs. 102, 103, 104) relating to income taxes on corporations, after which Mr. Alvord will deal with the subject of excess-profits tax (sec. 105) which should be considered together with the corporation income-tax rate.

Under the provisions of the bill, corporations with less than \$30,000 net income would have a small reduction of their taxes, while those with larger income would have their taxes increased. The available figures upon division of corporate income do not report those above and below \$30,000 but do as to those above and below \$25,000. Based on the 1932 income-tax returns, 92 percent of the corporations reporting net incomes had incomes of less than \$25,000, while 90 percent of the total income was reported by corporations which had incomes in excess of \$25,000. Computations made for the more prosperous years, such as 1926 and 1929, do not show any very striking variations from these percentages.

Senator GORE. That statement about the 90 percent, I did not get that.

Mr. CLAUSEN. That was, that 90 percent of the total income reported by corporations was reported by corporations which had incomes in excess of \$25,000 per corporation.

That is, 90 percent of the total.

Senator KING. Let's see if I understand you. I either don't understand you, or I don't remember the facts. My recollection is that of the number of corporations reporting net income, 90 percent of them did not have over \$25,000.

Mr. CLAUSEN. That is correct; they did not have over \$25,000; that is, they had less than \$25,000.

Senator GORE. You say 90 percent of the income came from concerns that had more than \$25,000?

Mr. CLAUSEN. Yes; that is correct; 90 percent of the income was reported by corporations which had income in excess of \$25,000.

For all practical purposes, therefore, the immediate effect of the proposed graduated schedule is to increase the tax rate one half of 1 percent upon nearly all corporate net income.

Aside from this immediate effect of the proposed graduated schedule, there is another exceedingly important aspect involved. Should the bill pass Congress there would be embedded in the law the principle and precedent of a graduated corporate income tax without relation to capital invested and based only upon the size of income. We must oppose any proposal that would establish this precedent, as it is wrong in principle.

We lay great stress on that. It is wrong in principle. The only argument we have heard for it this morning has been that the collections from it would be more uniform than under the present method.

Senator GORE. That is more or less speculative.

Mr. CLAUSEN. That, from a business standpoint, is no reason at all. That, of course, is speculative, based on the figures submitted, and it does not take into account the fairness of the tax, but it is rather measuring the ability to collect and not the ability to pay.

A graduated corporate income tax based solely on size without reference to other factors is indefensible. It cannot be supported by any principle of taxation or equity, or by logical reasoning.

An income tax of this character in nearly every case does not regard but runs directly counter to the principle of ability to pay. Take, for example, two corporations. The first has a capital of \$800,000,000 with earnings at 1 percent amounting to \$8,000,000. Another corporation has a capital of \$600,000 with earnings at 20 percent amounting to \$120,000.

The corporation with the smaller rate of return upon its capital would pay a higher rate of tax upon its income. Any recognition of the graduated rate, particularly if it should be worked out to a degree of refinement, must violate equity as well as the principle of ability to pay.

To carry on mass production or to give service commensurate with modern demands, large operating units in many instances are necessary.

The railroads and telephones are outstanding examples of this. One large corporation now gives telephone service of an efficiency

which was totally impossible in former times when telephones were owned by small local companies scattered throughout the country.

The railroads, originally built piecemeal by relatively small companies, were similarly forced, in order to give service, to combine into corporate units with large capital. Efficiency and the competitive pressure to reduce costs and prices compelled the automobile industry, at first carried on by small units, to form corporate organizations with large capital.

In various fields of business enterprise a tax with any considerable number of graduations would penalize those corporations which were compelled to acquire large capital in order to give efficient service.

In 1929, the latest date for which figures are available, 10 percent of the total number of establishments engaged in manufacturing employed over 70 percent of the total wage earners in the industry. Because of the necessity of large capital, all, or practically all, of the larger establishments mentioned are corporations. Any graduated tax which would place arbitrary limitations on the activities of these larger corporations would have serious repercussions on employment.

Senator GORE. You said 10 percent; what is that 10 percent of?

Mr. CLAUSEN. I said that in 1929, 10 percent of the total number of establishments engaged in manufacturing employed over 70 percent of the wage earners of the industry.

As I listened to the arguments this morning, I realized that with a graduated corporation tax of any extent it would not only complicate the picture when you start it, but in the working out of it there will be a triple tax on the same earnings.

I want to refer to a business I know a little something about, having been for 35 years connected with the farm-machinery manufacture, and since September 1933 director of code activities for the code affecting that industry. I might say there is an industry that has no protection of a tariff. We sell in competition with the world.

An illustration drawn from the farm-machinery business will prove our point. If you go back 15 years, when tractors were introduced on farms in this country, and consider what has happened to the intervening years down to the present time—when you find the development of that kind of power for the use of the agricultural sections of our country and of the world—you will observe that efficiency, service, stability, and higher wages have a definite relationship to size. By the way, there are eight establishments, separate and independent of each other, making farm machinery in this country, so competition definitely exists.

Tractors today are costing the farmer half as much as they did then. They are much different, much better, and much more efficient machines, and will do many more things than the original tractors would do.

Unless there had been large resources for engineering, for research, for experimental work, and for the purchase of equipment to produce these in volume, the development of the improved tractor on the farms of America today would have been impossible.

The six-hundred-odd companies in this industry were grouped under the N. R. A. code into four classes. Class A were institutions having over \$5,000,000 capitalization; class B were companies having a capitalization from \$1,000,000 to \$5,000,000; class C, from \$100,000

up to \$1,000,000; and class D, below \$100,000. Interesting figures developed when the code authority obtained reports from these companies as to the wages paid according to the size of the institutions.

Senator GORE. What character of industry was this?

Mr. CLAUSEN. Farm manufacturing, the manufacture of farm machinery. We found that, in class A, the large companies that is, over \$5,000,000 capital, the average rate of earnings in June 1934 was 60.2 cents an hour. In class B companies, the rate was 52.8 cents an hour; in class C, 47 cents; and in class D, 44 cents.

The situation that prevails in the farm-machinery industry in this respect, I dare say, prevails generally in all industries in this country; that the larger organizations which are more able to pay graduated income taxes than others, are the ones that are more able to pay better wages.

Senator WALSH. Is that not due to the fact that the employees are better organized in their labor organizations?

Mr. CLAUSEN. No; in the farm machinery industry only a small percent are organized now.

Senator WALSH. I thought they were better organized in the large concerns than in the small, generally speaking.

Mr. CLAUSEN. No, they are not; there are no closed shops in our industry.

Senator WALSH. Are your men organized at all?

Mr. CLAUSEN. One or two of them have works councils, but otherwise they are not very much organized in our industry.

I want to say higher wages because volume in the industry has a direct effect on the relation of labor to production. When you have an institution with a large volume of sales, each man produces a larger amount per person, and the wage runs higher; and with a program of this kind discouraging big business, as it might be called, and trying to cut down to small units, when the laboring man realizes the definite effect of that program, I think you will find more resistance from that source, than has yet been evinced.

Senator WALSH. What was the smallest percent there?

Mr. CLAUSEN. Forty-four cents. All of them are in the smaller institutions in the \$100,000 class, and located in the small communities.

Now, I think it can be shown that these large institutions that can produce economically can pay higher wages and produce a lower-priced product.

In a recent index of the Department of Labor it is shown that the equipment of a farmer costs less today than in 1914; that being the August issue of their monthly publication, containing that index. It reflects the ability of the larger institutions, better equipped, with better engineering and research, to produce lower-priced products.

When we go back a hundred years, when the vast majority of our people were on the farm, or in self-contained homes, then you have another picture. The 30 percent on the farm or now directly connected with them, are dependent for their markets on industry and commerce of this country, and when you lower the standards through reducing the ability to pay wages, you are affecting the man you no doubt in your minds and hearts want to help. It will be a directly contrary result.

Senator WALSH. Have you any figures in those corresponding classifications showing profits? In other words, the effect is this, namely, that profits were larger in the big industries than in the smaller.

Mr. CLAUSEN. There were one or two concerns in our industry that showed black for the year 1934, and that a very small amount. All of the others showed losses.

Senator WALSH. What you say I have found to be true in the textile industry, and the boot and shoe industry, due not only to what you have said, but due to the fact in the larger industries the employees are better organized, and are able to make their demands for wages more effective.

Mr. CLAUSEN. That may be so. Taking the National Industrial Conference Board report of returns to workers, there are two high ones; one is the printing industry, which is organized, and the other is the automobile industry, which is not organized, so that I don't think that point prevails as far as organization is concerned.

Senator GORE. Can you give the date of that Labor Department report to which you referred?

Mr. CLAUSEN. It is in the monthly publication for August. They bring that up to date each month.

Now, reference has been made to the large corporations, considering them as units, and a statement was made that there is no definite figure as to the number of stockholders in those concerns. That is true, but various estimates have indicated from four to seven million stockholders. Some of them duplicate, no doubt.

We do, however, have the number of stockholders in a number of these larger industries, and we can very definitely ascertain from those numbers that the corporations of this country are not owned by a few men, but by millions.

Senator GORE. Could you submit a schedule of that?

Mr. CLAUSEN. I would be glad to do so, the best that we have available.

During the depression the corporations gave employment to a great number of wage-earners. In addition, in order to relieve the hardships of unemployment, they also paid out large amounts to employees whose services were not actually needed to carry on current operations. A careful and conservative estimate is to the effect that during the 5-year period 1930-34 the manufacturing industry alone on its own initiative paid out a total excess of approximately 5.8 billion dollars to workmen.

The contribution of the manufacturing industry for relief of unemployment exceeds the amount paid out by the Government for public works and direct relief, the two forms of Government expenditures designed directly to relieve unemployment. While no exact data are available, other lines of business also did their share. Amounts of such magnitude could be paid out only by the larger corporations. Yet it is this type of corporation which would be discriminated against were an effective graduated tax put into operation.

Through a well-defined policy of reducing the amount of indebtedness and obtaining capital from stock issues, corporations prior to the depression were steadily improving their financial structure. Fixed charges were thus materially reduced or eliminated and corporations were more able to maintain solvency, even in the face of operating deficits. The income tax law provides, and properly so, that interest payments are to be deducted in computing taxable income. Were a well-developed graduated income tax in operation, in order to avoid the higher brackets there would be strong inducement for the corporations to resort to borrowing in some form. By

governmental action a sound and conservative business policy would thereby be penalized. If larger corporate borrowings were resorted to, then in case of another depression, the corporations with high proportionate fixed charges would be less able to weather the storm; bankruptcies would be increased and the shock to the economic structure of the country even greater than it has been in the last few years.

Those having the most vital interest in corporate taxes are the stockholders. The number of individuals owning corporate stock is large, the estimates being from 4 to 7 million. Speaking generally, the larger the corporation the larger the number of stockholders. In practically all the large corporations no individual owns more than a small fraction of the total number of shares.

According to official statistics, in 1932 only 356,000 people reported net incomes in excess of \$5,000; and in 1933 the corresponding figure was, according to preliminary reports, 320,000. Since the number of stockholders so greatly exceeds the number reporting net incomes in excess of \$5,000, it is obvious, and confirmed by general observation, that many people of very moderate means are owners of corporate shares.

Because of limited incomes, from necessity the amount paid this great mass of small stockholders must be largely spent for living expenses rather than saved for capital purposes. Consuming power so essential to recovery is increased by the distribution of dividends, and correspondingly decreased when dividends are reduced. The principle of a graduated income tax is unfair to this great mass of owners of small blocks of stock in large corporations.

The estimated income to accrue from the proposed graduated tax as written in the bill is only \$15,000,000. This amount is so small that it is obvious that the graduated principle is not advanced for the purpose of producing revenue. Why attempt the establishment of the principle at this time? We are at a loss to understand what can be gained by so doing. Its inclusion in the law can only have the effect of introducing another disturbing and uncertain factor in the business situation with no compensating advantage.

Now this program that has been advanced particularly by the President's message is a program that is not consistent, as I have stated, with the rapid return of men to employment in private industry.

It is consistent with a program that leads in an opposite direction, and the question very naturally arises, after listening to the statements of the representative of the Treasury Department, indicating a difference of viewpoint between the businessman and the representatives of the Government, does the Government exist for the taxpayer, or the taxpayer for the Government.

Senator KING. Thank you, Mr. Clausen. The committee will recess until 2:30 o'clock, to meet in the committee room of the District of Columbia in the Capitol.

(Thereupon, at 12:15 p. m., the committee recessed until 2:30 p. m. this day.)

AFTERNOON SESSION

The Committee on Finance of the Senate resumed consideration of H. R. 8974 at 2:30 p. m. in the District Committee room of the Capitol, Senator King presiding.

Present: Senators King (presiding), George, Walsh, Gore, Byrd, Lonergan, Gerry, Guffey, Metcalf, and Capper.

Senator KING. The committee will be in order. Professor Fairchild will be the first witness. I am sorry we have not a larger attendance, Professor, but your address will be printed tomorrow and distributed to the full committee and to all of the Senators.

**STATEMENT OF FRED ROGERS FAIRCHILD, PROFESSOR OF
POLITICAL ECONOMY, YALE UNIVERSITY**

Mr. FAIRCHILD. I am Fred Rogers Fairchild, professor of political economy, Yale University.

My connection with taxation has involved not only the academic investigation of theory and history but has brought me into contact with practical problems in connection with consulting work for business organizations and governments, at home and abroad, and through membership upon various national and State commissions.

I appear before you as a member of the committee on Federal finance of the Chamber of Commerce of the United States and also as representing the Manufacturers Association of Connecticut. I may say that this association has not undertaken to give me any instructions which would limit me in presenting my own views to your committee. With your permission, I shall develop briefly certain considerations, mainly of an economic character, affecting the tax problem before you.

I should say that certain facts which I will include in my statement have also been presented in connection with the testimony of certain of my colleagues on this committee before the House Ways and Means Committee.

First of all, I should like to call your attention to a common misapprehension which often confuses discussion of American tax problems. Reference is frequently made to the British tax system, so phrased as to imply that taxes in England are much heavier than in the United States and that, therefore, further tax burdens in this country are justified. Of course, the fact of heavy taxation in another country is no justification for increased taxation in this country which cannot be defended upon its merits.

Senator GORE. It is like one slave complaining that his chains were not as heavy as those of the others.

Mr. FAIRCHILD. Very much like that; yes. My point is that we must justify heavy taxes on their merits for this country; and if perchance we can keep ourselves in a more fortunate position than other countries, it would be well to do so.

Aside from that, however, many of the comparisons of relative tax burdens in America and in England are on an unfair basis and give erroneous impressions. Thus the British have no taxing jurisdictions levying such heavy taxes as do our State and local governments, and the taxes collected by the British Government, therefore, represent a much larger portion of total taxes than do our Federal taxes. Yet comparisons are usually made between the taxes of the two National Governments without taking account of State and local taxes.

Again, comparisons are ordinarily made of two taxes only—income taxes and death taxes. It would be equally fair to make a comparison of our general property taxes and the British “rates”, namely, the

property tax levied by local communities in that country, and by this process show that Americans are taxed much more heavily than are the British. As a matter of fact, even the comparisons of the taxes upon incomes and estates indicate that the larger incomes and larger estates are now taxed as much as or even more in this country than they are in England.

In these comparisons it usually is not recognized that tax policies and administrative procedure in Great Britain, such as the right to carry losses forward, the method of determining true net income, particularly of taxing or exempting capital gains, and the prompt and final adjustment of tax liabilities, mean a much lesser impact of the income tax in England than a mere comparison of the rates would suggest. No one assumes that in our country a comparison of the general property-tax rates of two cities might be made without consideration of the method of treating assessed valuation. So, too, no one should make a mere comparison of income- or estate-tax rates between England and the United States, giving no attention to the provisions of law determining the amount of the taxable income or estate.

The British system is much fairer in the matter of income derived from dividends. Full credit is given there for the amount levied against the corporation in connection with these payments. In the United States only 4 percent (the normal tax) is allowed on dividends, although the corporation making the payment is taxed at least 13½ percent. In effect, a double income tax of 9¾ percent is paid to our Federal Government alone. In addition, various of our States apply their own income taxes, granting no deductions for taxes paid at the source.

The corporate-tax rate in Great Britain is a standard rate of 22½ percent on profits.

Senator KING. Is there any tax on capital stock?

Mr. FAIRCHILD. No, sir.

Senator KING. Just tax on profits?

Mr. FAIRCHILD. Just the tax on profits.

Senator KING. What are the deductions?

Mr. FAIRCHILD. I have not all of the details, but they allow deductions which, on the whole, are rather more generous than ours for expenses; and then, as I shall show in a moment in my statement, there are offsets for dividends paid to their stockholders. I am just coming to that.

The corporation recoups itself by deducting the standard rate of tax from payments made in the form of interest or dividends and consequently itself bears the tax on undistributed profits.

In Great Britain corporations, like individuals, are not subject to income taxes by political subdivisions of the Government, as they are in many of our states. The 22½-percent corporate rate is not much higher—even taken on a mere comparison of rates—than that paid by corporations domiciled in many of the States of this country. A corporation domiciled in New York must pay a State income tax of 4½ percent, which may soon be increased to 6 percent. If a State tax of 4½ percent is to be added to a Federal tax of 14¾ percent, there is a total tax of 18¾ percent upon a New York corporation. Under the conditions under which such rates will be levied in the United States, the percentage of tax in relation to net income of the corpora-

tion might be actually greater than that of the 22½ percent standard rate in Great Britain.

The death dues in Great Britain are less onerous upon large estates than they are in our country. There are no gift taxes in England but very heavy ones in the United States. The legacy and succession taxes in England, which correspond in nature to the proposed inheritance tax, are insignificant compared with the rates that are suggested in the House bill. The British legacy and succession tax rates are moderate compared to those now in force in the States in this country.

Furthermore, in that country there are not the multiplicity of income, franchise, capital stock, excise, and other taxes bearing upon corporate enterprises that are levied by the States and the Federal Government in this country and to which it is now proposed to add new, and, in our judgment, inequitable burdens.

Finally, it should be pointed out that the whole tax situation in the two countries is materially affected by the condition of their national finances. In Great Britain, with its budget balanced, with a substantial reduction in tax rates already granted last March, and with the prospect of further relief in tax rates as business improves, the taxpayers' outlook is quite different from that which now confronts the American taxpayer.

INDUSTRIAL CONDITIONS, TAX RATES, AND REVENUE

As having a most important bearing upon pending tax proposals, I wish to emphasize, what I am sure has often been brought to your attention, that the revenue from income taxes, death taxes, and most other taxes is affected far more by economic and industrial conditions than it is by the rates of tax imposed. This principle is illustrated by recent trends in Federal taxes. Reference has been made to the fact that we are experiencing some increase in taxable income, in other words, some broadening of the base of the income taxes. For example, corporation and individual income taxes received by the Government in the fiscal year, which ended on June 30, 1935, were greater by 35 percent than corresponding receipts in 1934 and 47 percent greater than in 1933. It is evident that such improvement in business conditions as we have already experienced, has had its effect in increasing the Federal revenues.

I have here a page of detail in which that percentage is brought out for different years and for certain fiscal periods of different years, with which I will not weary the committee, assuming that that may be printed in the record.

Senator KING. Yes, it may be inserted.

(The inserted matter is as follows:)

Going into greater detail, the following figures are significant with respect to the yield from the Federal income taxes, corporate and individual.

In the fiscal year 1927 the Government received from the corporation income tax \$1,300,000,000, and almost the same amounts in the fiscal years 1928, 1929, and 1930. In 1931 it received about \$1,000,000,000 which dropped to about \$600,000,000 in 1932, to less than about \$400,000,000 in 1933, and to \$400,000,000 in 1934. It appears to have run in the fiscal year 1935, just closed, about \$572,000,000—an increase over the previous year of 43 percent.

If we compare the yield of the corporation income tax in the first 6 months of this calendar year with a similar period in other years, we find that for the 6 months ended June 30, 1935, it produced \$337,000,000 in contrast with \$232,000,000 in the same period in 1934, \$180,000,000 in 1933, and \$250,000,000 in

1932. It is to be noted that the yield of the corporation income tax the past 6 months was 62 percent greater than in the corresponding period of last year and 87 percent greater than in 1933.

On the same basis, namely, the first 6 months of the calendar year, the individual income tax collections this year amounted to \$342,000,000 which contrasts with \$266,000,000 in the first 6 months of 1934, \$222,000,000 for 1933, and \$189,000,000 for 1932. It is to be noted that the yield of the individual income tax in the past 6 months was 29 percent greater than in the same period last year and 80 percent greater than in 1933. Noting that there has been some increase in the rates affecting individual incomes, the proportion of the greater yield that is due to increased rates in contrast with increased volume of income cannot be determined through the lack of official figures as yet, but other computations indicate a considerable increase in the volume of individual incomes in 1934 upon which taxes have been paid in the past 6 months.

If these comparisons be made on the collections for a single month, it is to be noted that taking the month of June, just closed, in 1934, the corporation income tax collections were \$135,000,000 as compared with \$97,000,000 in 1934, \$72,000,000 in 1933, and \$96,000,000 in 1932. Similarly in June 1935, the individual income tax collections were \$117,000,000 as compared with \$89,000,000 in 1934, \$44,000,000 in 1933, and \$64,000,000 in 1932.

Taken together the corporation and individual income taxes produced in the fiscal year 1935, just closed, \$1,099,000,000; in 1934, \$817,000,000; in 1933, \$747,000,000; in 1932, \$1,057,000,000. It will be observed that the last fiscal year shows an increase in the yield from the income taxes of about 35 percent over 1934 and 47 percent over 1933.

"Taking the collections in the past 6 months from the corporation and individual income taxes and comparing them with previous years, we observe that in the first 6 months of 1935 the receipts were \$679,000,000; in 1934, \$498,000,000; in 1933, \$402,000,000; and in 1932, \$439,000,000. The past 6 months show an increase over the same period last year of 36 percent and over the same period of the previous year, 1933, of 69 percent.

Taking the month of June alone, the combined yields of these income taxes were \$252,000,000 in 1935; \$186,000,000 in 1934; \$116,000,000 in 1933, and \$160,000,000 in 1932. The increased yield of corporation and individual income taxes in June this year over last year was 30 percent, and over 1933, 117 percent.

Senator GORE. Have you shown the results that followed after the reduction in the rates in 1924, 1926, and 1928?

Mr. FAIRCHILD. No, sir; I have tried to make these comparisons such as they were independent of changes in the rates, because the point I am trying to bring out is that the change in economic conditions will both increase the revenue and decrease the revenue.

Senator GORE. I see your point. After each of those reductions in the rates, the revenues increased.

Mr. FAIRCHILD. Yes, sir. The point I am making is that this recent increase in revenue is not the result of any increase of the rates, but the result of increase of business conditions.

Recent experience likewise demonstrates that, in the absence of income and business activity, increased rates cannot produce as much revenue as smaller rates applied to and conducive to a larger tax base.

In 1930, with a maximum surtax rate of 20 percent, a maximum estate tax rate of 20 percent, a corporate income tax rate of 11 percent, with only a limited number of excises, the Government collected from these sources over \$3,000,000,000 in revenue.

In 1935, however, with a maximum surtax rate of 59 percent (in contrast to 20 percent), a maximum estate tax rate of 60 percent (in contrast to 20 percent), a corporate income tax rate of 13¾ percent on most corporations (in contrast to 11 percent), and with a host of additional excises, these same sources yielded the smaller amount of 2.7 billions, some \$300,000,000 less. Showing that the change in

industrial conditions has been sufficient to more than offset the increase in rates all along the line, which has taken place between 1930 and 1935.

It is, in our judgment, and in the judgment of my colleagues on the chamber of commerce committee, clear that the determining factors in producing revenue are not high rates—certainly not extremely high rates—but the amount of taxable incomes and the volume of taxable business activities. The present tax system of the United States would quickly produce very much greater revenues should normal business activity be restored. Without such industrial recovery our tax system will produce little additional revenue even though rates be drastically increased.

In addition to this, there is the grave danger that the imposition of such drastic increases may, as has been pointed out by other members of the chamber's committee, have an adverse effect upon business activity and so tend to defeat their own ends so far as revenue is concerned.

That the tax burden upon corporations is already very heavy in the United States is indicated by many of the annual reports of our corporations. For instance one of them shows that in 1934 taxes consumed about 42 percent of total revenues. Another shows about 30 percent consumed by other than processing taxes. These companies were chosen at random and doubtless many more striking examples could be found.

Senator GORE. Could you indicate what your processing tax was in the latter case?

Mr. FAIRCHILD. I have not the figure for that.

Senator KING. Do you mean the entire processing tax?

Senator GORE. No; this particular concern which paid 30 percent of its total receipts out in taxes, not including processing tax.

Mr. FAIRCHILD. I think we could supply that figure if the committee would like it. I haven't it at hand.

The American Iron and Steel Institute recently stated that during the last 6 years taxes consumed 66.4 percent of the earnings of the steel industry. It has been estimated that in 1934 taxes consumed 32 percent of the telephone income and 28.88 percent of the net revenue of class I steam railroads.

I have worked out here a specific example of a New York corporation to show what its total tax burden would be, and without bothering you with those details, I assume that can be included in the record.

(The inserted material is as follows:)

As a practical illustration of the effect of these taxes upon a corporation, let us take as an example a manufacturing concern located in a medium-sized city in up-State New York. The corporation has a capital stock value (and an adjusted declared value for Federal capital stock tax purposes) of \$1,000,000. Before the New York State income tax it had a net income of \$209,494. Before arriving at that net income, the corporation had paid taxes as follows:

Property tax on an assessed valuation, at \$30.45 per thousand.....	\$10, 650
License tax on 25 motor vehicles, at \$9 each.....	225
Tax on 28,000 gallons of gasoline, at 4 cents.....	1, 120
Tax on lubricating oil.....	15
Total.....	12, 010

The above are not all the taxes paid, but are among the more obvious ones.

The State and Federal income, capital stock, etc., taxes would be as follows:

State income (franchise) tax at 4½ percent.....	\$9,494
Federal capital stock tax.....	1,000
Federal excess-profits tax.....	12,000
Federal corporation income tax.....	28,350
Total.....	50,844

The total net income of the corporation before any taxes were paid would be \$221,504.

The net income available for dividends and surplus after all taxes were paid would be \$158,650.

The taxes would total \$62,834.

Taxes would constitute 28 percent of the net income before taxes and 39 percent of the net income after taxes, being the amount available for dividends, etc.

Senator LONERGAN. Do you include the local taxes, or are you confining your remarks to Federal taxes?

Mr. FAIRCHILD. These are all taxes, and that is brought out in this New York example which I presented, in which each of those State and local taxes are separately listed.

Senator LONERGAN. Without going into details, you may tell us the aggregate.

Mr. FAIRCHILD. This was a concern in an upstate town in New York. The corporation has a capital stock value and an adjusted declared value for Federal capital stock tax purposes of a million dollars. It had a net income before paying its New York State income tax of \$209,000. Before arriving at its actual net income for Federal purposes, it paid a property tax of over \$10,000, motor-vehicle license tax, gasoline tax, lubricating-oil tax, and so forth, making taxes of \$12,000, and then on the remaining net income for State income tax it paid \$9,494, Federal capital stock tax of \$1,000, Federal excess-profits tax of \$12,000, Federal corporation-income tax of \$28,000, making \$50,000 and leaving \$158,000 of the total income of \$221,000 available for dividends.

The taxes altogether, State, Federal, and local, totaled \$66,000.

In my opinion, the most important present consideration in connection with the Federal taxes is to seek to preserve and encourage business activity, and to avoid anything which may jeopardize the prompt return to economic prosperity.

I think that we should not forget that when we get into income taxes, both on individuals and corporations at these extremely high rates, that we are in effect passing out of the field of income taxation into the field of capital taxation, because those taxpayers, whether individual or corporate, which are called upon to pay these very high rates in the high brackets, as in the bill before you, can scarcely be expected to find annual income sufficient to meet those taxes, and although income taxes in form, they approach capital taxes or capital levies in actual effect. They would do so in the case of many taxpayers.

Senator LONERGAN. Professor, such a condition would result in destruction of business, would it not?

Mr. FAIRCHILD. That really is the point that I am chiefly interested in, Senator Lonergan. I do not have any brief to defend the wealthy against taxes here at all. I am far more concerned with the repercussion of the tax program upon the common people who, while they may think that these taxes do not touch them, that these taxes are

directed only against the very rich, and that therefore they have no concern with them, have nevertheless a vital stake in the economic soundness of American industry.

After all, if to get about a quarter of a billion dollars, the Congress takes action which injures the prosperity of American business, it won't be primarily the very rich men who will suffer the burden, but it will be the wage earners and the farmers, and the people generally whose well-being depends upon a healthy state of business and industrial activity.

Senator LONERGAN. Professor, have you any views on this, that where an estate cannot pay, will the Government not be obliged to take over the business, and will that not result in socialized industry?

Mr. FAIRCHILD. I have given a good deal of thought to that, Senator, and at the extreme I think that is what we see before us. I would hesitate to say that in the particular measure we accomplish that particular result, the measure that is before us now, but we are certainly going in that direction.

The first effect, of course, of extremely heavy estate taxes is to cause a separation of a part of a going enterprise from its present owners. At the very best, they must get the money by the sale of some of their equity in the concern.

Senator GORE. That is tantamount to a capital tax, is it not?

Mr. FAIRCHILD. Of course. The first effect of that might not be socialization; it might simply be that somebody else became the owner in place of the present owner, but as Senator Lonergan suggests, if you carry that far enough, and bring all of industry more or less into this net, the upshot will be that there will be nobody to buy these securities thrown on the market, and the Government may have to take them over.

Senator LONERGAN. Business thrives as a result of efficient management, does it not?

Mr. FAIRCHILD. Certainly.

Senator LONERGAN. So there would be no guaranty on the part of the Government that efficient management would carry on, that efficient management might go out and start industry of its own. That is true, is it not?

Mr. FAIRCHILD. That concurs with my views.

Senator LONERGAN. And it is something we should think about?

Mr. FAIRCHILD. Most certainly. In fact, I think that is really the vital issue in this whole tax program.

Senator KING. Any tax system that destroys capital and year by year invades the capital structure is bound to have a detrimental effect, an injurious effect upon your economic structure?

Mr. FAIRCHILD. It certainly is; and its effect while unseen and incapable of precise measurement, I can say without hesitation is far greater in magnitude than the few million dollars of revenue that the Government may get from such taxes.

Senator GORE. Is not the worst defect that it dries up the source of future revenues?

Mr. FAIRCHILD. Yes, sir.

Senator KING. Proceed further. We have a large number of witnesses, and we want to push the hearing as rapidly as we can.

Mr. FAIRCHILD. Concluding this particular aspect, I would simply add that in my opinion this has been brought out by the questions of

the Senators, that the most important present consideration in connection with the Federal taxes is to seek to preserve and encourage business activity, and to avoid anything which may jeopardize the prompt return to economic prosperity.

Just a word, if I may, about the relation of this tax program in its relation to State revenues.

Tax measures such as are now before your committee cannot be properly considered without noting their effect upon the revenues by our State governments. There is already evident a tendency on the part of the Federal Government to encroach upon the tax resources of the States. The proposals under consideration would continue this tendency.

Higher taxes upon incomes would mean a lessened ability of the States to obtain revenues from that source. The greatly increased number of excise taxes now being levied by the Federal Government, including the productive gasoline tax, also affect the ability of the States to obtain revenues. The addition of an inheritance tax—which is a source of revenue that has been regarded as peculiarly belonging to the States—would reduce the possibility of the States deriving increased revenues from death dues. This tendency of the Federal Government in moving directly toward a monopoly of revenues is especially questionable just now when the State and local units of government have heavier fiscal burdens and are being pressed to assume a larger share of relief expenditures.

Senator KING. Professor, have you given attention to the question which has been suggested to me in these hearings from the testimony, as to the rights of the Federal Government to impose inheritance taxes, keeping in mind the fact that the States determine the devolution of property, who may own the property, and who may succeed, and who may be the heirs, and so on? In other words, under the power of the State, the determination of the ownership and devolution of property is peculiarly within the powers of the State, rather than the Federal Government, and if that be true, would be any taint of unconstitutionality upon an inheritance tax?

Mr. FAIRCHILD. I might remind you, Mr. Chairman, that you will hear next from Mr. Osgood of our committee, who is far more of an expert on the subject of inheritance taxes than I. I do not want to evade your question, and I can just say in a word that it has always been my feeling that death duties properly belong to our States, not only for the technical constitutional reason which you raise, upon which I do not presume to give an authoritative answer, but also from the economic and fiscal viewpoint.

The States had developed those taxes before the Federal Government did, and the Federal Government taxes have been regarded as war emergency taxes up to the time of the ones imposed at the time of the World War, and while it may be that we are never going to remove those taxes entirely from the Federal Government, I do agree that on every ground the States have a prior claim there. I know Mr. Osgood will be able to develop that question far better than I can.

Senator LONERGAN. Do you think with the same fund, with a State inheritance tax and a Federal inheritance tax, that there can be any justification for them? Do they not represent a double levy on the same sum?

Mr. FAIRCHILD. Yes; they represent a double or more than a double levy, but of course should the Congress in its wisdom determine to raise a certain amount of money by a combination of estate and inheritance taxes instead of by an estate-tax law, I do not know that you could find fault with the former as being double taxation. I think you could criticize it as being administratively less satisfactory than the estate tax.

I am very firmly convinced that the estate tax is in principle superior to the inheritance tax.

Senator KING. We have double taxes now. We have income taxes in the States and Federal Government, and I understand that New York City has an income tax. I may be in error in respect to that. Then we have double taxes, the donor and the donee are taxed after they get their inheritance.

Mr. FAIRCHILD. In that sense we have plenty of double taxation.

Senator KING. Proceed.

Mr. FAIRCHILD. No one can, I think, pretend that the additional revenue to be derived from tax proposals now pending will be of any significance in the way of reducing the present deficit of the Government. The most optimistic estimates place such additional revenue in the neighborhood of \$270,000,000, a small matter, indeed, in relation to a budget deficit of \$3,000,000,000 or \$4,000,000,000. Moreover, such consideration as the chamber's committee has been able to give to the matter would seem to indicate that the estimate of \$270,000,000 is far too optimistic.

In the estimates of the yield of taxes in the House bill, it is not apparent that allowance has been made for the fact that high taxes on corporate profits, estates and inheritances will decrease the base of the personal-income tax and lessen revenues from that source for the future. Higher rates on the great bulk of corporate income must mean curtailment of the amount received in dividends by stockholders who, in many instances, pay their income taxes at a higher rate than do the corporations. In 1932, for instance, the latest year for which data are available, individuals who pay on their incomes at a higher rate than the corporate income tax reported dividends amounting to 82 percent of their total income. Transfer of increased amounts of taxable income from the high individual rates to the corporate rates would obviously decrease revenues from the individual income tax.

In view of the shrunken incomes of corporations and individuals, the losses yet to be recouped, and the present methods of imposing taxes, there is basis for belief that the rates and effects of the tax policies now in force already bear too heavily upon the types of personal or corporate enterprise that we must depend upon to produce recovery.

Evidently then the enactment of the proposed tax measure would do practically nothing at this time—I mean during the present fiscal year—toward relieving the Federal deficit. On the other hand, there is reason to believe that these measures might actually increase the financial difficulties of the Government through checking the return of industrial activity.

Indeed, so far as the immediate effect upon the Federal deficit is concerned, reduction of expenditures, such as I believe could be easily accomplished, would be more effective and less disturbing than the tax increases which are being proposed. My associates in the work of

the chamber committee are preparing a memorandum upon the possibility of the reduction of Federal expenditures, which memorandum will be submitted later for inclusion in the record if you desire. Briefly it indicates the directions in which a reduction of \$500,000,000 could be sought or an amount twice the most optimistic estimates of additional revenues that might be produced by the House bill. The direction of larger reductions than \$500,000,000 and up to a billion and a half are indicated.

In this connection it is of interest to note that in the fiscal year just ended on June 30, 1935, the total receipts of the Government amounted to 3.8 billion dollars. This amount is more than five times the total expenditures incurred in any of the fiscal years 1914, 1915, or 1916, and is sufficient to have paid all expenses in each of the fiscal years 1922, 1923, 1924, 1925, 1926, 1927, 1928, and in some of those years would have left a sizeable surplus. In 1929 there would have been a small deficit of \$48,000,000.

Finally, I think we cannot avoid considering the relation of pending tax proposals to the broad problem of the Federal finances. I am sure that the members of this Committee are well aware of the widespread and growing alarm occasioned by the continued heavy deficits in the Government's finances.

Senator GORE. You think that is a fact?

Mr. FAIRCHILD. I have not the slightest question of it, Senator; not only a fact, but I think, as I say, it is increasing in intensity and in the number of people who are coming to appreciate it.

Our outstanding need today in this country is for a well coordinated fiscal plan for the Federal Government with a rigid control of expenditures, every possible reduction in their amount, and a determined effort to attain a balance of income and outgo. Beyond that, there is a crying need of simplification and clarification of our revenue laws. I have argued that the present tax proposals offer no real help to the budget problem. Moreover, it is not open to question that a graduated corporation income tax, an excess profits tax, higher surtaxes, and the addition of an intricate and high inheritance tax with the provisions that have been suggested would add complexities in the revenue plan and to the rate structures and would mean greater difficulty of administration and of compliance by the taxpayer.

Sooner or later the time will come when the whole problem of the Federal Budget must be squarely faced and resolutely acted upon. When that time comes, it will be necessary to consider not only revenues but also expenditures. Balancing of the Budget will require both drastic reduction in expenditures and a broad overhauling of the whole tax system. And the Congress will find itself freer to take wise action if its planning is not complicated by ill-advised action previously taken involving unfortunate increases in the rates of certain taxes.

Since it is proposed in the House bill that its provisions affecting income taxes shall apply to taxable years after December 31 next, except in the case of the excess-profits tax which shall apply in the taxable years after June 30 next, and since even in the inheritance tax it is suggested that it apply after enactment of the measure, with long periods for payment of the tax, there would be little or no additional revenues in the current fiscal year, ending June 30, 1936. The Budget of expenditures for the subsequent fiscal year, beginning July

1 next, will not be before the Congress before next January, although its preparation presumably is now under way. Under these circumstances and the added one that recent legislation and bills now in conference will have a very direct bearing upon Government revenues and expenditures, it would seem advisable for the Senate to defer action upon the proposed revenue bill until the beginning of next year, less than 5 months away.

If the interval were utilized to prepare a well coordinated fiscal plan covering revenues and expenditures, a great benefit to the country, instead of the detriment under the present procedure, might be obtained. It would appear that if the Congress insisted upon doing this there would be overwhelming public approval and support. A reasonable delay, with whatever expense and effort may be involved, in order to obtain a well coordinated fiscal plan in the next 5 or 6 months in preparation for decision upon revenues and expenditures in the next session of Congress is certainly justifiable in view of the outstanding importance of the matter.

It is my firm conviction that the time to make adjustments in income taxes and death taxes is in connection with the overhauling of the whole tax system incident to the establishment of a consistent revenue system which shall be adequate to meet the expenditures of the Government.

Now, Senator, if you could grant me two or three minutes more time, there is one point in the testimony of the representative of the Treasury Department relating to the principle of ability to pay upon which I should like to speak.

Senator KING. You may. Be as rapid as you can.

Mr. FAIRCHILD. I will be very brief.

It was suggested in this statement yesterday that the present tax system is defective at this moment because the proportion of revenue taken in the form of taxes that bear upon ability to pay has shrunk, and the proportion from consumption and other similar taxes has increased during the past few years.

In this connection, there was set before the committee, a conception of the principle of ability to pay which I think would never be recognized by the students of taxation as I know it.

The assumption seemed to be that there is some ideal proportion between taxes that rest upon the ability theory, and consumption, and similar taxes, and that when that proportion is thrown out of gear, as it was claimed now to have been, the remedy is to raise income tax rates, raise death tax rates, and bring in more revenue from that source in order to restore that proportion.

If we are to be logical, I suppose it would follow that if business conditions had gone the other way, if we had great prosperity in the last few years and the contribution from income and estate taxes had become more than this ideal proportion, then the logical remedy would be to reduce the rates of income and the estate taxes to bring the proper proportion between the ability to pay taxes and consumption taxes back again.

If that is the notion, we have the very curious situation that when the business is prosperous, personal and corporate incomes are heavy, the contribution from them shall be made lower by lower rates, and when business is struggling with depression and adversity, the rates shall be made higher on an amount of income.

Of course, everybody knows that the ability theory implies that if you pay taxes according to ability, when your ability goes up, you pay more, and when it goes down you pay less; and everybody knows that the reason that income and estate taxes have fallen down in their yield in the last few years is because the incomes of these taxpayers have been so drastically cut by the economic depression.

Furthermore, the idea that you can take taxes and put them in two groups, one of which rests upon ability to pay and the other does not, is quite foreign to my understanding of the theory and the practice of taxation.

There are in the United States, or there were in 1933, about a million and a half people, individuals who paid an individual income tax.

Senator GORE. How many?

Mr. FAIRCHILD. About a million and a half who paid it.

Senator GORE. What year?

Mr. FAIRCHILD. 1933. Something over 3,000,000 who made returns.

Senator GORE. What year was this?

Mr. FAIRCHILD. In the year 1933; that is the latest year that we have the figures for.

Now, let us suppose that those people represent about four times that number on account of the families and dependents. I think that is rather liberal. Let us call it 6,000,000 who bore the burden of the individual income tax.

Let us add to that, those who bore the burden of the corporation taxes and estate taxes.

Estimates of the number of individual stockholders in this country runs anywhere from four to seven millions. Suppose we take the bigger figure of 7 million. Take off from that the one and a half million who paid income taxes, because certainly practically all of those must have been stockholders, and you add about five and a half millions of people who bore the burden of the corporation income taxes—I do not think we need to add much for the estate taxes—but let us say that we get 6,000,000 plus 5,500,000—that amounts to twelve or thirteen million people.

Those are the people who in 1933 were paying these so-called “ability-to-pay” taxes. But what about the other 112,000,000 people in the United States?

The inference apparently is that they have no taxpaying ability. They are not called upon to pay the taxes based upon ability to pay, but they make their contribution if at all, through other taxes.

Any notion that out of 125,000,000 people in the United States, only some 12 or 13 or 14 million have taxpaying ability is a most extraordinary theory for a government of the people, by the people, and for the people.

Of course, the fact is that ability to pay is not completely reached by the income tax by any means. It certainly is not the fact that only 12 or 13 million people in this country have ability to pay taxes and should be called upon to have a financial stake in the cost of their own National Government. That is absurd.

The fact is that ability is very widely extended, and that a sound tax system resting upon ability to pay cannot rely wholly upon the income tax for that purpose, but must set up a constructive consistent tax system which will reach ability. The income tax is a very use-

ful tax to reach the ability of the wealthy and the well-to-do. It reaches, as we have seen, something like 12 or 13 million people and that is all.

To reach the rest, the great bulk of the population of this country, most of whom should certainly expect to make some contribution toward the cost of their Government, we must resort to other taxes or else bring the income tax lower down by lower personal exemptions. Even with that, you would not bring in anything like the majority of the people of the country through the income and estate and similar taxes.

The principle of the ability to pay tax, it seems to me, includes the consumption taxes. The consumption taxes wisely devised, are a necessary part of the tax system in order that the ability to pay of those people who are not reached by the income tax may be properly reached. That is getting into questions which naturally will come in whenever the whole budget system or the fiscal system of the country is considered.

Senator KING. That would involve a general system of sales taxes, would it not?

Mr. FAIRCHILD. Sales tax is one device for reaching the ability of those who do not pay the income tax. But my point is that when you approach those problems, you must have a sensible notion of what ability to pay means, and not a notion which would relegate 112 out of 125 people into the class of no taxpaying ability.

Senator GORE. Talking about a sales tax does not necessarily bear any relation to ability to pay.

Mr. FAIRCHILD. I think it does, Senator. I think it bears a perfect relation.

Senator GORE. Well, assuming a pauper who would not spend a cent or have anything, he would be exempt. The next grade above that would buy something or other. I do not think that would necessarily bear any proper relation to his ability to pay as compared with the man who is buying luxuries and comforts. I do not think your proposition clicks at that point. What is a consumption tax that is not regulated by or graduated with reference to ability to pay? What is a tax that has no bearing on the ability to pay?

Mr. FAIRCHILD. My opinion is that all taxes have some bearing on the ability to pay, because they have tax base which is larger for the wealthy than it is for the poor. Even your consumption taxes.

Senator GORE. Not necessarily. A value tax sale would not.

Mr. FAIRCHILD. If you want an example, you might take the medieval salt tax. That is a very good example of a hard-boiled tax without reference to ability to pay, because the tax is the same on all. We keep that out. The tax on gasoline and the tax on tobacco—

Senator GORE (interposing). You take the tax on gasoline. I think that is an ideal class of case. I do not think that has any bearing on the ability to pay. I know that during the depression, people were buying a gallon at a time.

Mr. FAIRCHILD. But it still is true that the wealthy man with the heavy car on the long trips uses more gasoline and pays more tax than the poor man, and the man with no car at all is exempt from the tax.

Senator GORE. Yes; but he pays more in proportion to what he gets, not more in proportion to what he is able to pay. That is not

the standard that determines it. It is what he gets. If a rich man, a millionaire, buys 1 gallon of gasoline and pays 3 cents tax, and if a pauper buys 1 gallon, he also pays 3 cents tax. I do not get this consumption sales tax related to ability at all. I think that it has a fundamental defect within it.

Mr. FAIRCHILD. I hope that you are not putting me in the position of advocating a sales tax as opposed to an income tax. I am simply suggesting that a combination of income tax and certain consumption taxes is necessary.

Senator GORE. A sales tax has two virtues; it produces revenue, and it makes everybody pay, but not in proportion to the ability to pay.

Senator KING. Many of the States are adopting the sales tax because so many other avenues of revenue have been taken by the Federal Government.

Senator GORE. We are not going to spare anything or exempt anything from taxation. This idea that you can reduce taxation is a mere idle dream.

Senator KING. I think you are right about that. The burden of taxes is going to mount instead of being diminished, and the Federal Government is setting an example along that line.

Senator GORE. In my last platform, I want to get this into the record, are just 6 words and 3 promises: Less taxes, more trade, and no trusts—and I am sticking to it. I want to take the ax out of tax, too.

STATEMENT OF ROY C. OSGOOD, FIRST NATIONAL BANK, CHICAGO, ILL., UNITED STATES CHAMBER OF COMMERCE

Senator KING. What is your position with the First National Bank of Chicago?

Mr. OSGOOD. Vice president of the First National Bank of Chicago and in charge of its trust department activities.

I have been administering estates in the bank for 30 years, dealing daily with problems of estate and inheritance taxes. I appear here, however, as a member of the committee on Federal finance, Chamber of Commerce of the United States.

It has happened that in connection with the work of organizations, such as the National Chamber, the Chicago Association of Commerce, the Investment Bankers Association of America, the Corporate Fiduciaries Association in Chicago, the National Tax Association, and in various official and unofficial conferences upon the subject, it has been necessary for me to devote attention to legislation relating to taxation upon estates and inheritances and the administration of such legislation by Federal and State officials.

The President in speaking of taxes upon legacies referred to "very large amounts." The House bill, however, would impose taxes upon the net value of inheritances (after deduction of specific exemptions) ranging from 4 percent on \$10,000, by brackets up to 72 percent upon \$10,000,000 and 75 percent on larger amounts. It is stated that the schedule would produce \$86,000,000 annually, and the accompanying gift tax schedule would produce \$24,000,000 annually.

The inheritance taxes would be in addition to the existing Federal estate taxes.

The following figures indicate the percentages of different-sized estates which the present death taxes combined with the proposed schedule of inheritance taxes would absorb.

I am going to read a half dozen illustrations, and in them will be included, as near as can be estimated, the State inheritance tax involved on account of the 80 percent credit, as well as the Federal tax.

(Basis of computation: The net estate figures are net estates before deduction of exemptions. The taxes computed are the Federal estate taxes under the 1926 and 1934 Acts; State inheritances and estate taxes; and proposed Federal inheritance taxes. In figuring the taxes imposed by the States it was assumed that they would not exceed 80 percent of the Federal estate taxes imposed under the 1926 Act, but that the full 80 percent was taken.)

On an estate of \$500,000, with one heir who is a near relative, the combined taxes would amount to 32 percent; with three such heirs it would amount to 21 percent; with one heir other than a close relative it would amount to 35 percent.

On an estate of \$1,000,000 with one heir who is a near relative, the combined taxes would amount to 41 percent; with three such heirs they would amount to 32 percent; with one heir who is not a close relative they would amount to 43 percent.

On a net estate of \$5,000,000, with one heir who is a near relative, the taxes would absorb 62 percent; with three such heirs, 54 percent; with one heir who is not a near relative, 62 percent.

On an estate of \$10,000,000, with one heir who is a near relative, the taxes would absorb 72 percent; with three such heirs, 65 percent; with one heir who is not a near relative, 72 percent.

On a net estate of \$30,000,000, with one heir who is a near relative, the taxes would absorb 83 percent; with three such heirs, 82 percent; with one heir who is not a near relative, 83 percent.

In the case of a \$100,000,000 net estate, there would be a Federal estate tax in amount of 58.4 percent. If the balance went to one heir, who was a near relative, it would be subjected to an inheritance tax of 71.3 percent, making a net total impact of 88.1 percent.

Senator KING. Did I understand you to say that an estate of \$100,000,000 would only pay 56 percent?

Mr. Osgood. No; an estate of \$100,000,000 would pay a Federal estate tax of 58 percent. If the balance went to one heir, that is, the remainder after paying that 58 percent went to one heir, and it was subject to the rates of the new inheritance tax bill of 71.3 percent, it would make a total tax of 88.1 percent.

As to the expected yield, it is to be noted that the present estate taxes, which mount upward to the rate of 60 percent, and which decrease estates before inheritances can come out, brought in only \$140,000,000 in the 12 months ended with June 10, 1935. It would not seem reasonable to expect, even without allowing for some credit to the States under the estate tax that \$86,000,000 would be produced in a single year from a tax on bequests alone. It will be noted, furthermore, that since the inheritance tax may be payable over a period of years, it is reasonable to suppose that for quite a number of years to come the \$88,000,000 per annum could not be obtained even if that estimate be correct.

To give some perspective upon the impact of the inheritance tax schedule in the House bill, it may be well to take an actual case.

A New York citizen who died in October 1930, left a gross estate which was appraised at \$72,740,838.

According to reports of official record the total costs against that estate were as follows [reading]:

Debts.....	\$5,027,543
Administrative expenses.....	454,105
Attorneys' fees.....	400,000
Executors' fees.....	4,050,361
New York estate tax.....	9,513,013
Federal estate tax.....	2,283,103
Total costs.....	21,728,125

That was before the 1932 act went into effect.

Under the present Federal estate tax rates the total costs of settlement of that estate payable in cash would have amounted to \$46,000,-706. There was a shrinkage of \$8,355,000 in value of the securities after death. After allowing for this shrinkage and payment of total costs there would have been left for distribution to the beneficiaries the sum of \$18,384,250, or about 25 percent of the original gross estate.

If it be assumed that this \$18,384,250 were bequeathed to one heir who is a near relative, it would be subjected to a Federal inheritance tax of \$12,162,287, or to an heir who is not a near relative, to a tax of \$12,192,287. In other words, the net amount that would be left in both cases from the original gross estate would be only about \$6,200,000, or 8½ percent of the original estate, or a little over 9 percent of the estate that was left after the deduction of the debts.

It might be well to recall here that there are numerous instances of record where the existing or prior Federal estate taxes combined with the inheritance tax of the State government, the shrinkage in value of estate after death of decedent, the executors' and attorneys' fees and administrative expenses have amounted to the total value of the estate. Since that was true, without a Federal inheritance tax, it is apparent how much more likely to be the case in the event titles II and III of the House bill are enacted.

Senator KING. As I recall it, at the end of the year, there is a provision that there should be a revaluation of the estate after the first valuation.

Mr. OSGOOD. There is a provision for shrinkage as it stands now. If the executor chooses to wait a year, as I understand it, he may have the advantage of the shrinkage in values even though no sale has actually been made.

Senator WALSH. The Treasury Department expressed its view yesterday that they would be willing to extend that time, and they proposed to prepare an amendment. Perhaps you were present?

Mr. OSGOOD. I was not present, but I have been over the testimony of the representative of the Treasury Department on that particular point. It indicated to me that he was perfectly willing to advocate a change in the direction of not waiting for a year possibly, but letting any bona fide sale showing the shrinkage in the estate and give the estate and the Government a division of the tax based on the actual shrinkage of actual securities sold, which is better even than the provision in the House bill.

Senator WALSH. What you have stated about shrinkage that has taken place in the past, that unfortunately is true in the case of many estates.

Mr. OSGOOD. I have noticed in the press this morning that the representative of the Treasury Department referred to one very large estate, naming specifically the Ford estate. I would not have gone into those figures had he not done so.

According to the figures he presented, if after the share of Edsel Ford had been taken out on account of that part of the Ford stock that had been given to him, there would have been left something like \$354,000,000 on the basis of the valuation figures of the Ford business presented. We figured that the total tax imposed by existing Federal and State taxes—probably the tax in the State of Michigan, assuming that it absorbs the full 80-percent credit allowed—would amount to about \$316,570,000 of the remainder, which would leave, if Mr. Ford gave the rest of the property that he now owns—

Senator GORE (interposing). Will you state that again, please?

Mr. OSGOOD. It left something like an estate now in Mr. Ford's hands of \$354,000,000. The tax would be about \$316,570,000 as proposed by this bill, and under the existing Federal estate tax, leaving him about \$27,500,000.

Keep in mind that this is a going business, and while even assuming that a payment to the Government of \$316,000,000 could be financed by refinancing the Ford Corporation, say by putting out a bond issue for part and selling common stock for the remainder and preferred stock, the chances are that the shrinkage on the market incident to the sale, that is, the wholesale value as distinguished from the retail value of the stock, would probably absorb a good part of that \$27,000,000 and wipe out every cent of the Ford estate.

Senator WALSH. Mr. Jackson pointed out in that statement that young Ford had 47 percent of the common stock?

Mr. OSGOOD. I took that out in my calculation. Nobody doubts that the Ford stock would be a good investment, assuming management was there.

Senator WALSH. He was trying to point out that it would not be a hardship to young Mr. Ford, because of his ownership of so much common stock.

Mr. OSGOOD. There is one assumption in his conclusion, and that is that the younger man will outlive the older. Accident may destroy that method of calculation.

It seems to me if those steps were carried out logically in the present bill, the whole Ford fortune would disappear from Mr. Ford's beneficiary.

Senator GORE. Would that put the success of the business in jeopardy, as well as the continuity of the business?

Mr. OSGOOD. That would put the continuity of the business as far as the family is concerned, in the hands of Mr. Edsel Ford, which he now holds, assuming such figures are correct, plus such hired ability as he might be able to hire to carry on the continuity of the business.

Senator KING. If loans had to be made to the carrying on of the business, it would place the control of the property perhaps in the hands of Wall Street or the bankers, possibly to the disadvantage of the institution.

Mr. OSGOOD. At least the people who placed the bonds and the stock would feel that they had a moral responsibility to see the thing through. That, I think, is what you are leading to.

Senator BYRD. Suppose the elder Mr. Ford should die in 1 year and the younger Mr. Ford the next year.

Senator GERRY. There is a statute covering that of 5 years, if I recollect that.

Mr. OSGOOD. The statute that covers that for 5 years is unfortunately omitted in this bill. I will come to that in my subsequent testimony. If this bill is going to be passed, it should be put into this bill as well.

Senator GERRY. Should it not be longer, because if you are going—depending upon how many years the Treasury is going to allow the winding up of the estate, and if you have to borrow money in order to wind the estate up and pay the taxes the banks are going to want to know what the possibilities are, and if two deaths can occur one right after the other, the difficulty of borrowing is that much greater, because you have two taxes.

Mr. OSGOOD. There is no doubt about it.

Senator GERRY. Of course, you have had some examples of that in England. They had them during the war. That is why that provision was put in.

Senator WALSH. It is not in this bill?

Mr. OSGOOD. No.

Senator LONERGAN. Is this not true, that in all probability that would be treated as a forced sale, and that being so, the price would be far below the appraised valuation? That is one thing, is it not?

Mr. OSGOOD. Yes. You will notice that I state that with these \$354,000,000, with \$316,000,000 of tax, there is left \$27,000,000. Normal underwriting costs, that is, the difference between the wholesale and the retail price of securities, runs about 10 percent. If they were 10 percent in this case, that would be \$35,000,000 and the Ford estate instead of having anything like that, would owe the Government money with nothing to pay it from.

Senator LONERGAN. It is purely speculative as to the ability of the estate to pay, and the ability of the estate to go out and sell the stock.

Mr. OSGOOD. Senator Lonergan, I have not even in this instance assumed any shrinkage at all, and we all know that it exists.

Senator GORE. The Ford business without any bonded indebtedness at all is a very different institution than the Ford business with \$350,000,000 of bonds outstanding against it.

Mr. OSGOOD. Yes, sir; and with Mr. Ford running it.

Senator KING. Proceed, Mr. Osgood.

Mr. OSGOOD. I am afraid I am going to weary the patience of the committee, because I am going to give you specific objections on the specific provisions of the bill. If I may, I would like to go through with them.

Many of the provisions of the inheritance-tax sections are obviously faulty. These will be discussed by sections.

Section 202 (a), rates: The rates reach even the smallest estate. If a decedent without close relatives leaves all of his property to a nephew, the rates would reach his estate even though it amounted to \$10,000. The multitude of detail involved in such a schedule is apparent. It should be particularly noted that the bill contains no

provision, as in the case of the Estate Tax Act, providing that property taxed within 5 years is not again subject to tax. Under the bill, the tax may be levied a number of times in the same generation.

You asked about the length of time, Senator. A generation we generally figure is 33 years. I think 5 years is the longest provision I know of in any inheritance or estate-tax statute.

Senator BYRD. You say that is omitted from this bill?

Mr. OSGOOD. Yes.

Senator BYRD. In other words, if the two Fords died in one year, they would both have to pay? Can you answer that question, how much would the tax be on both estates if they both died in the one year?

Mr. OSGOOD. I would be glad to submit the computation.

Senator BYRD. There would be very little left?

Mr. OSGOOD. I am afraid the figures would be ciphers.

Section 202 (b) and (c): There seems to be a general failure among readers of the bill to understand the provision relating to the formation of corporations for avoiding the tax. There is also no clear understanding of the method of computing the tax in the event of the formation of such corporation, or the import or justice of the provisions relating to existing so-called "family corporations."

I never have seen such a corporation myself in my 30 years of experience. I would like to know what they are.

Section 203, taxable and nontaxable transfers: Four of the headings in this section relate to "transfers" and the other four relate to "receipts" of property. This is a confusion of terms which becomes apparent when it is considered that under section 202 the tax is imposed "upon the right to receive or acquire any property." If the tax is upon the receipt, it cannot be upon the transfer. Apparently, the bill has been framed upon the misconception that an excise tax on a transfer is the same as one on the right to receive.

Section 203 (a) (4) and (5): Subparagraph (4) deals with powers of appointment and powers to alter, amend or revoke.

I might say that this whole question of power in an inheritance tax statute is one of the most complicated that anybody ever runs into.

Subparagraph (5) is also concerned with such powers and seems to be, in part at least, a repetition of subparagraph (4). In connection with such powers paragraph (e) of section 201 should also be noted. According to this paragraph, certain powers in connection with property "are deemed the equivalent of such property." It would seem, therefore, that the donee of a general power of appointment would be taxed on the full value of the property. The property involved would also be taxed under the present estate tax in the estate of the donor. Then, upon the exercise of the power, the recipient of the property would again be taxed on its full value under subparagraph (4), and the property would also be included in the estate of the donee of the power under the present estate-tax law. This subjects property which involves a general power of appointment to four separate taxes. It is apparent that this penalizes general powers of appointment and would result in their abolition. As a matter of fact, the use of the term "in favor of his estate" in section 201 raises the question as to whether the same effect would not be had on limited powers of appointment. It might be argued that a power limited to the heir or children of the decedent is a power in favor of his estate.

Section 203 (7), insurance: This taxes the receipt of life insurance taken out by a decedent on his own life, even though the decedent "did not have the right to change the beneficiary or have any legal incident of ownership." When the decedent irrevocably designated a beneficiary other than his estate and divested himself of the incidence of ownership a gift tax must have been paid, both under the present gift-tax law and under title III of the bill. The insurance then became the property of the beneficiary so designated. This provision is probably unconstitutional.

Senator KING. Would the tax be levied as of the date of the transfer?

Mr. OSGOOD. The tax would be levied as of the date of death, that is, on the valuation as of the date of death on the property that the man did not own.

Section 203 (b), dower not taxable: The bill does not tax "dower, curtesy, or a statutory estate created in lieu of dower or curtesy." This results in unfair discrimination between States and between older and younger people. For example, community property States are given an advantage over common-law States. In the former, one-half of the specific property would be exempt, while certain other States, like Illinois, would exempt only one-third. This would tend to cause among older people, and those of wealth, an effort to minimize the effect of the tax by establishing residence in a State most favorable to the surviving spouse. Younger persons, because of business ties or other reasons, would be unable to make such a change. The pressure on State legislatures to correct this situation might result in competition between States to attract and hold residents.

You are familiar with other legislative competition of the same general character.

Such a provision would encourage a widow to elect to take her statutory estate rather than accept the terms of a will, and thus defeat the testator's intention. In order to cure this defect, the bill should include as an exemption the amount of property of which a decedent cannot deprive a surviving spouse.

Section 203 (e), relinquishment of marital estates: This provides that the release of dower should be a consideration "only to the extent of the value thereof at the time of the decedent's death." This provision might result in unfortunate consequences. Suppose as a property settlement a man of substantial means creates a trust of a portion of his property in consideration of his wife's release of dower and other statutory rights. By the terms of the trust the wife would come into the property upon the death of the husband. Since the wife takes the property at such death, the transfer is taxable unless there was adequate consideration. If the husband should die penniless except for the trust fund previously created for the benefit of the wife, the wife's dower measured by the value of the property at the time of the decedent's death would be nothing, and consequently the receipt of the property under this provision would be taxable.

Section 204, gross value of beneficial interests: Subparagraph (a) provides that the "gross value" shall be determined as of the date of the decedent's death. The meaning of "gross value" is not defined. How can there be a "net" and a "gross" on one fixed sum received? This confusion becomes apparent when section 205 (deductions) is considered.

Senator KING. Is there no definition in the bill of "gross" and "net"?

Mr. OSGOOD. I do not see how there can be if they both relate to the same thing.

Senator KING. I am asking you if there has been any attempt to define them?

Mr. OSGOOD. I have not seen any.

For example, one item of deduction is funeral expenses. What do funeral expenses have to do with a general bequest of \$100,000? If a testator leaves a diamond stickpin to his son, how can funeral expenses be deducted? This inheritance tax is based upon what the beneficiary receives, which is the proportionate share of the estate after all deductions of costs of administration and the like. There are, however, other deductions which are pertinent but not included in the section. Suppose a testator leaves his residence to his wife. Assume it has a value of \$200,000 and is subject to a \$50,000 mortgage. Is the beneficiary to be taxed on the basis of \$200,000, without deducting the mortgage? The same principle would apply to liens against collateral loans.

Senator KING. Does not the bill indicate that there would be a deduction for liens?

Mr. OSGOOD. No; not so far.

Senator WALSH. If that situation existed generally in an estate, it would be very easy for the tax here to wipe out the whole estate?

Mr. OSGOOD. Yes.

Senator WALSH. In other words, if the value were fixed of a residence at \$200,000, and there was a \$50,000 mortgage, and the \$50,000 mortgage was not deductible, it would be easy to wipe out the whole estate.

Mr. OSGOOD. Here is one of the strangest anomalies I have ever seen in a tax provision. I have a feeling that perhaps I am responsible for it, because in my testimony before the House committee, I said it was silly for the Government to try to change an easily collectible tax like an estate tax into an inheritance tax, and that lawyers, in drafting wills all over the country—it was common for them to change an inheritance tax to an estate tax by providing that the taxes and the cost of the administration be paid out of the residuary estate. It did not change the amount of the tax any, but some members of the committee seemed to fear that there was some evasion in the situation. There is not a particle.

At any rate, there appeared in this what is known as "subparagraph (b)."

Subparagraph (b) creates a mathematical monstrosity.

Senator GORE. Do you make any point of that?

Mr. OSGOOD. Not in comparison with some other provisions of the bill; no, sir.

It provides that a direction in a will to pay the tax out of the corpus shall be considered as increasing the amount of the bequest. If a testator gives his son \$100,000 and provides that the tax be paid out of the residuary estate, under this section it would require a complex mathematical computation to figure the exact amount either of the bequest or of the tax. This provision would require most persons to completely revise their wills, and makes it practically impossible to make bequests of a fixed amount. Many persons of advanced age, or

of present mental incapacity, who have valid existing wills, will have no opportunity to change them, and the provisions will result in enormous injustice in many cases. The provision appears both silly and obnoxious. I am sorry I cannot find any milder terms to use.

Senator GORE. Is that not, in a way, putting a tax upon a tax?

Senator WALSH. I suppose the Treasury will be asking you to explain these objections or act on them.

Mr. OSGOOD. I hope they will be asked to eliminate that provision.

Senator KING. I have no doubt Mr. Jackson is taking cognizance of this testimony. He is here, and we will be glad to receive any suggestions he may have.

Mr. OSGOOD. Section 205, deductions: Paragraph (a) (5) limits the amount of a widow's award to \$10,000 a year. The statutes of the various States have provided the methods of determining such awards, but under this provision every State court would have to take into consideration the amount of the tax in determining the amount of a widow's award necessary for her support. The amount of this arbitrary exemption is obviously open to the objection that it places definite hardships on a widow whose standard of living has been above the figure stipulated.

Section 205 (a) (6): This provides for deductions for casualties or theft if the loss has not been taken as a deduction "in an income-tax return." The ultimate beneficiary has no control over deductions taken by an executor, so that the provision is palpably unfair. If the executor, by chance or design, takes a deduction in his income-tax return, the beneficiary is penalized, because he is required to pay a tax on the full value.

Section 205 (a) (7): This provides for a deduction of the shrinkage between the date of death and 1 year after. The estate, however, may still be open and the property not received for several days after death. In such an event, a beneficiary who thus has no control over his prospective bequest cannot protect himself against subsequent shrinkage. Further, the bill gives the executor or other person 18 months from the date of death within which to file his return. Such a return cannot be filed before the expiration of a year, because the person filing the return would be unable to ascertain the shrinkage. As a practical result, this would mean that one has only 6 months within which to file the return.

Section 205 (b), specific exemptions: This provides for specific exemptions, the most important of which is for the benefit of immediate relatives and dependents. The exemption, however, does not include a son's widow, a daughter's husband, the issue of an adopted child, or great-grandchildren, all of whom are of the same general class as those mentioned specifically. There seems no good reason for such discrimination.

Senator GERRY. They are in most State statutes, are they not?

Mr. OSGOOD. Yes; they are. Sometimes they do not go to the son-in-law or the daughter-in-law, but they do go down to great-grandchildren, and they take into consideration adopted children, if the testator has stood in relation of parentage to them for a certain time.

Section 206, contingent estates: One of the principal problems in such a tax upon life estates is the treatment to be accorded as emergency clause in a trust. If a person is given a life estate and the trustee is empowered to use principal for the benefit of the life tenant

in certain emergencies, how is the life estate to be valued? It is not known when such an emergency will arise. Neither is it known how much principal will be used for such a purpose. If the life estate only is valued, and a tax paid on that basis, and the remainderman pays a tax upon the balance, it is apparent the remainderman is paying a tax upon property which he may never receive. If the tax upon the life estate is computed and paid immediately, then upon any disbursement of principal under emergency clauses, is a new return to be filed covering such a payment?

Senator KING. You say there is no provision in the bill that clears that question up?

Mr. OSGOOD. No; and I do not know whether it can be cleared up in an inheritance-tax act.

Senator WALSH. If there is anything in these contentions at all, there will have to be a new bill written, will there not?

Mr. OSGOOD. I am not hitting all of the things, either, Senator Walsh. I am just hitting the high spots.

Senator WALSH. I think the Treasury will be able to show that you have some misconceptions.

Mr. OSGOOD. Section 206 (b), assets which may be divested: While this deals with estates which may be divested, it only provides for those which may be divested by an act or omission of the beneficiary. What method of computation is to be used in determining the tax upon estates which may be divested by the happening of an event beyond the control of the beneficiary?

Section 206 (c), composition of tax: This provision is particularly unfair to the taxpayer. According to the bill, in the case of a contingent estate, the Commissioner will compromise the tax "in the interest of the United States." In reading the remaining portions of this section, it is not certain whether this compromise includes a contingent remainder.

Section 206 (c) (3): This provides that a tax on a contingent remainder is to be held in abeyance until the contingency has occurred, but that the Commissioner shall require a bond to secure the payment at the future date. If no bond is filed, then the tax is payable at once, computed at the highest possible rate. There is no provision for refund. That is serious. The effect is to force the taxpayer into whatever compromise the Commissioner will accept. The difficulty, if not impossibility, of obtaining a bond running over a possible period of 75 years or more is apparent. Yet, if the compromise is not reached upon the Commissioner's terms and no bond can be secured, a higher tax may be paid than subsequent circumstances warrant, and the taxpayer would be without redress. This savors more of coercion than compromise.

Section 206 (c) (4): This provides for the filing of a return and the collection of a tax at the time of the happening of the contingency, but provides that values shall be taken as of the date of death, and interest collected at the rate of 4 percent, compounded annually. This could easily result in the gravest injustice and would create apparently impossible tax liabilities for an unreasonable length of time. Assume that a testator leaves property to a trustee to pay the income to a son for life, and after the son's death to a grandson in being, and after the grandson's death to pay the principal to the issue of the grandson none of which issue are in being at the present time, and failing such

issue, then to charity. The remainders in such a case may not fall in within a period of 50 or 60 years.

In other words, 50 or 60 years from now the Government would assess a tax based upon present values and collect interest on that tax at 4 percent per annum, compounded annually. What would happen with this tax in existence, if a trust of this kind had been created by the will of a testator who died in 1929 when prices were at their peak and with the enormous subsequent decline in values? What would happen to the income of a trust created now with the tax computed at 4 percent compounded annually when the income of the securities in the trust could not safely produce much over 3 percent? Even in an ordinary case, it is apparent that with a slight shrinkage in value of principal, the Government may be attempting to collect a tax which actually exceeds the value of the property.

In connection with this provision, it should be noted that the bill contains no method for valuing estates for years.

Section 208, returns: This requires the filing of a return "if the beneficial interest transferred to such a person exceed \$10,000 in total gross value, or comprises an interest the tax with respect to which cannot be determined because of a contingency." It has already been stated that such a provision reaches even the smallest of estates. Under this provision, a person acquiring a contingent interest of the value of 50 cents must still file or have filed a return. A person dying, with only \$10,000 in value of property, comes within the provision even if it is all left to his widow. Why is it necessary to file a return for a widow who receives \$10,000 when there is no tax liability except on the excess above \$50,000?

The administrative difficulties may be amplified. For example, what is to be done about insurance proceeds in the possession of insurance companies. The executor may never see such property. Suppose a man dies, leaving only \$10,000 of insurance and a \$1,000 estate. How can his executor file a return covering the insurance?

A return is required for every contingent interest. What is the executor to do regarding unborn children who have contingent interests? How many children must he assume for such a contingent interest?

It is interesting to note that all of these duties imposed upon the executor in most cases must be performed without additional compensation, since various State statutes have already fixed executors' fees.

Section 210, payment of tax: This provides that a person having possession or control of property "shall be liable to the executor for the tax upon such transfer." This would mean that every insurance company would be liable to every executor of a decedent who had insured with it. With such liability facing insurance companies, how can they avoid increasing the cost reflected?

Section 210 (d): This provides that if an executor makes an overpayment of the tax, the beneficiary shall be entitled to reimbursement out of the estate undistributed. It is difficult to understand how this can be done legally, since of necessity such reimbursement must come from property belonging to another. How can an executor be justified in taking property from one beneficiary to reimburse another beneficiary for an overpayment in the tax? The whole theory

of this is inconsistent with the avowed nature of the tax, that is, a tax upon the right to receive. A major portion of the duties and liabilities are imposed upon one who does not receive the property. Here again there exists confusion between an estate and an inheritance tax.

Section 210 (f): This provides for an extension of the time of payment not exceeding 10 years. It is entirely inconsistent with an executorship which is generally closed within a year. If an executor is to be made personally liable for the tax, and the time of payment is extended 10 years, must the executor keep the estate open for that period of time? This provision is also inconsistent with the lien imposed by section 211.

Senator KING. May I interrupt you there. I assume that that extension to 10 years was included in the bill in order that estates might not be sacrificed. Your remark here would seem to indicate that at the end of a year, the executor ought to close up the estate. Don't you think that that would be fatal?

Mr. OSGOOD. No; I do not think it would be fatal as to a year. I noticed that the representative of the Treasury in his testimony yesterday produced some rather interesting statistics tending to show that there was very little danger of a shrinkage or little injustice from shrinkage on account of the number of extensions asked in each particular year, say from the 1900's and-some-odd down.

The answer is that extensions are asked for only in the cases of the greatest hardship. An executor does not dare, for instance, having fixed liabilities in the form of debts and taxes on the one side, and property of fluctuating valuation on the other, he cannot afford to gamble so long, if you choose to call it gambling, because it is an uncertain quantity on the one side and a fixed and certain quantity on the other, and if he does it wrongly, he is subject to surcharge. That is why the estates are settled without extensions being asked for.

Another reason is that extensions bear 6 percent. Unless your shrinkage is extremely high, in a market sliding down, the executor cannot afford to pay 6 percent for the extension, because it is greater than the income of the estate. Very few estates will net, as you know, much more than 4 or 5 percent.

Senator GERRY. Is it not also true that the executors would not want to pay out any income to the heirs or could not pay out any income to the heirs or the widow while the estate was being liquidated if the estate was liable to have the tax represent the entire value of it?

Mr. OSGOOD. Yes, that is true. And I am coming to the question which, if this bill is passed, must be corrected, a very glaring error in the bill, and that is the question of liens.

Senator GERRY. Certainly. That is elementary.

Senator KING. Before you leave that, if I may be pardoned, what suggestion would you make to deal with that rather perplexing matter?

Mr. OSGOOD. I have never found an answer. My answer is very simple and has been simple since we made an intensive study of it in a group of States all over the country in 1924, and that is to go to an estate tax. Keep away from the inheritance tax.

Senator KING. I agree with you.

Mr. OSGOOD. May I say this, Senator, that in the testimony of the representative of the Treasury yesterday, he alluded to the fact

that the United States had had a number of inheritance-tax acts. Nearly all of the States had inheritance taxes up to about 1924, but they were low taxes, with the rates low, when fiscal demands were comparatively simple, but since the demands have become greater and the situation has become complex, it is interesting to note that since 1924, 30 States have passed estate-tax laws as distinguished from inheritance-tax laws. They have all found it impossible to administer future-interest provisions.

Senator GORE. What is the economic or fiscal justification for having both systems, an estate tax and an inheritance tax? Is it not double, double, toil and trouble, with only one ulterior point, and that is to force people to distribute, force the people with large fortunes to distribute to a larger number of distributees to escape the tax? That might be an incidental reaction.

Mr. OSGOOD. Possibly. I think seven or eight States have repealed the inheritance taxes entirely and substituted estate taxes.

Senator GORE. Would it not be better if you wanted to realize a certain amount of increased revenue, just to increase the estate taxes?

Mr. OSGOOD. Yes; if they will stand raising. If you want to do it, do it in a simple fashion and get away from all of this mess that this bill raises. I do not believe the draftsmen themselves know how it can be worked out.

Senator GERRY. Of course an estate tax is a tax on the large family. That is the argument.

Mr. OSGOOD. I doubt if the technical draftsmen of the bill believe that its provisions can be worked out and enforced. My staff could not work it out.

Section 210 (g): This provides for interest on extended payments—3 percent for the first 3 years, and 6 percent thereafter. It should be kept in mind that this interest is an addition to the interest on the extended estate tax. The result would mean in an estate, where difficulties of liquidating were faced, that the total interest payments would amount to 12 percent per annum. Further interest payments are required under State laws. Thus, it is possible with a slight shrinkage in the property for the total taxes to exceed the value of the property.

Section 211, lien for tax: This lien is imposed for a period of 14 years from the date of the death of the decedent. This is true, even though there is no question about extending the time of payment. Why is it necessary to continue the lien for such an additional length of time? The lien under the estate tax is for only 10 years. The lien provisions are impossible of execution and would be ruinous in their application. This lien section has entirely lost sight of the usual statutory provisions for the automatic removal of the lien in the case of property sold and its attachment to the proceeds. Without a provision of this character to complement the provision now in the bill, the liquidation of securities and other property for the payment of the tax would become impracticable and impossible.

You would have to stamp every security in the estate before you passed it on, that there was a Government lien on it. The remedy is perfectly simple, and would undoubtedly be applied if the bill is passed just as in the estate tax law.

Section 218, period of limitation: The limitation on assessment is 10 years after the return is filed. In the case of the filing of a return for a recomputation of the tax upon the happening of a contingency, the statute of limitations is 5 years from the date of the filing of such return. The statute of limitations for collection is 6 years after the assessment of the tax, or the expiration of an agreed extension.

On the other hand, the statute of limitations on refunds to the taxpayer is 3 years after the time the tax is paid, and refunds are limited to amounts paid during the 3 years just preceding the filing of the claim. In other words, the Government has 10 years and the taxpayer 3. It seems clear what the effect of this would be in the case of installment payments. Suppose it were agreed that the tax be paid in installments over a period of 10 years. The taxpayer makes payments for 6 years, and then discovers, or it is determined, that the tax was wrongfully assessed. The effect of the limitation provisions would be to allow a refund only for the sums paid in the preceding 3 years and the amounts paid during the first 3 years would be lost to the taxpayer.

Section 226, Transfer to estates; section 227, Notice of fiduciary relationships: While these provisions are substantially the same as those in the Estate Tax Act, they must be considered in their application to the framework of the present bill.

It is apparent from the manner in which this bill is framed, that an attempt is made to impose an inheritance tax based upon estate tax principles. It is, of course, well recognized that the administration of inheritance taxes in the States has been so unsatisfactory that some States have abandoned the inheritance tax in favor of the estate tax. The bill attempts to combine the ease of administration of an estate tax with the special consequences of an inheritance tax. The result makes for confusion and disaster.

As an example in the bill of an attempt to draft it along lines of an estate tax, attention is called to the use of the word "transfer" when the tax is upon the "receipt." The provision for deduction is, of course, necessary in an estate tax, but is meaningless in an inheritance tax. The same may be said with reference to losses and deductions for shrinkage. The bill places the greatest burden upon the executor, as does an estate tax when, as a matter of fact, the tax proposed by the bill is on the beneficiary.

The experience of the States shows it is impossible to avoid a multitude of detail in an inheritance tax. An unsuccessful effort in the drafting of the present bill to avoid that multitude of detail has resulted in a hybrid scheme which produces neither an estate tax nor an inheritance tax.

That is the end of my specific remarks. I would like permission, if I may, to append a second statement, without taking the time of the committee to read it, which goes into the question of insurance protection and certain economic effects of the bill itself.

Senator GORE. On that, I would like to ask you one question.

Senator KING. You may have an opportunity to file it with the reporter.

(The extension of Mr. Osgood's statement will be found at the conclusion of his testimony.)

Senator GORE. The point was raised, I think Miss Curtis, a day or two ago with regard to exempting from insurance policies the amount

deducted to pay the death duties. As I understand it, the limitations of the insurance companies themselves as to the amount of insurance they will grant at different ages and so on, would virtually make that policy a point of application unnecessary, would it not? Impractical?

Mr. OSGOOD. No, Senator; I think it is a practical plan, and I think if we are going to increase your estate or inheritance taxes, that some provision has got to be put in where a man can insure for it without an added tax for the amount of the insurance. I am not interested in any insurance company at all, either.

Senator GORE. Would it be convenient for you or your lawyers to submit a draft of that?

Mr. OSGOOD. There is included in this memorandum provisions of the laws on that point, of the Canadian Provinces. They practically all permit it.

Senator GORE. And some of the States do too, do they not?

Mr. OSGOOD. Kansas is about the only one that really does it in a decent way, but I think as our taxes get heavier, the States will come to it, and it seems to us it is absolutely vital.

Senator GORE. That is embodied in your memorandum?

Mr. OSGOOD. Yes.

Senator LONERGAN. Mr. Osgood, in a certain percentage of cases, a man would be unable to pass the physical examination, even assuming that he had the money to pay the premium.

Mr. OSGOOD. Perfectly true.

Senator LONERGAN. That is true; is it not?

Mr. OSGOOD. That is true.

Senator LONERGAN. This is an important thing. The existing law, as I understand it, is that where a man has his life insured and the beneficiary is his wife or another dependent, the exemption is \$40,000, and any sum in excess of that is taxable?

Mr. OSGOOD. Correct.

Mr. LONERGAN. Where the policy is payable to his estate, the exemption is \$50,000, and any sum in excess thereof is taxable. That is the existing law.

Mr. OSGOOD. I think \$40,000 is the only exemption.

Senator LONERGAN. I got an opinion from Mr. Parker, our tax expert.

Mr. OSGOOD. He may be right.

Senator LONERGAN. In the Ways and Means Committee, so I have been informed, an amendment was offered removing all kinds of exemptions on the proceeds of life-insurance policies. I would like to have your opinion on that.

Senator WALSH. Is such a provision in this bill?

Mr. OSGOOD. That is my understanding, and that it passed the House.

Senator LONERGAN. That they have removed all exemptions.

Senator WALSH. They have removed all exemptions?

Senator LONERGAN. Yes; on the proceeds of life-insurance policies, and made them taxable. I want to get your opinion on that. I have very hurriedly read your statement, and I am going to read it with care, because I am greatly interested in it.

Mr. OSGOOD. I think the administrative burdens passed upon the insurance companies by the bill itself are very burdensome.

Aside from that, of course, there is an economic difference as to whether or not insurance should be taxed at all.

Senator KING. You mean insurance policies?

Mr. OSGOOD. Yes. I can conceive under some circumstances they ought to be taxed, and probably if you were going to exempt them all from taxation today, it would cost the Government in this period, I don't know how much, but some considerable sum in estate taxes.

Senator LONERGAN. Pardon me. You mean above a certain sum?

Mr. OSGOOD. Above a certain sum, yes. But I do think this, that if insurance is taken out and payable either to the executor or the estate or to a trustee, or payable to the Government for the purpose of paying a tax, that it should be exempt. That is, if it is earmarked for that purpose. I think that those who disagree on the economic theory of taxing insurance would probably agree to that.

Senator LONERGAN. Give me your three points again.

Mr. OSGOOD. I think I would probably put a provision in the law, even in the Federal estate tax law as it exists today, exempting insurance where it is taken out for the purpose of paying taxes.

Senator WALSH. Why should we distinguish between savings resulting from paying premiums to insurance companies, and a bank account?

Mr. OSGOOD. Senator, you have asked the question that causes the economic disagreement, but if you take out insurance—suppose for instance—

Senator GORE (interposing). And earmark it?

Mr. OSGOOD. Suppose for instance I know that the provisions of this bill are going to cost my estate close to \$50,000, and I go to an insurance underwriter, and I say I want to increase my insurance \$50,000 and earmark it.

Senator GEORGE. It never really becomes an asset of the estate in the true sense; is that not the true answer? It is an asset, but it is devoted to a specific purpose. Is it not a general asset on which you can operate?

Senator WALSH. You can cash it in during your lifetime.

Mr. OSGOOD. If you do cash it in, it becomes a part of your estate. But it seems to me that both the Government and the taxpayer would benefit.

Take the case of a man, for example, who has a large amount of real estate and that is practically all that he has, and he knows that it has to be sold at forced sale to pay a heavy inheritance tax. Why should he not insure against such a contingency?

Senator GEORGE. It is to the interest of the Government to get its taxes and to get them promptly. And while the estate in that instance of course has an added asset, it is an asset already pledged to a specific purpose, and it seems to me sound ground of public policy that there should be an exemption up to some reasonable amount at least.

Mr. OSGOOD. You will find in the examples given here what it costs to insure at the present time in order to provide a given amount of insurance for a given estate.

Senator METCALF. Suppose it were an old man who could not get insurance?

Mr. OSGOOD. He might possibly be able to get term insurance, or possibly not even enough insurance.

Senator GORE. Either age or health might prevent him.

Senator KING. Have you suggested in paper which you have prepared or supplemental to it, any amendments to the pending bill?

Mr. OSGOOD. No, sir. I always hesitate to do that, because I think the committee and its draftsmen know the technical provisions a good deal better than an outsider can.

Senator GORE. Would this be feasible? Where a man who has taken out insurance years ago and gotten older and lost his health, could make provision that he could set aside and dedicate a part of the insurance he had carried, and bring it in to this category?

Mr. OSGOOD. Yes. It might be of some practical effect.

APPENDIX TO STATEMENT OF ROY C. OSGOOD

INVASION OF STATE FIELD

An estate or inheritance tax is not technically regarded as a levy on the estate or legacy but is imposed on the devolution or transfer and is measured by the size of the estate or legacy. Rights of succession are determined wholly by the States and the Federal Government has no jurisdiction over them.

The States have long levied death dues and in order to preserve to some extent the revenues which the States derive from this source it was provided in 1926 that estates would be allowed a credit for death taxes paid to State governments but not in excess of 80 percent of the tax due the Federal Government. The 1932 and 1934 revenue acts did not disturb this credit provision, which was computed under the lower rates of the 1926 act, but imposed an additional tax without any credit allowed thereon for taxes paid to the State governments.

It is proposed under the present bill that the Federal Government invade the inheritance tax field traditionally reserved to the States and no mention is made of sharing in any way the proceeds with the States. This is an encroachment obviously by the Federal Government upon the revenue resources of the States which in most cases are not now sufficient for them to carry out their public obligations.

These proposals, under all the circumstances, and the rates which in practice must prove confiscatory, clearly indicate that the objective cannot be solely to raise revenues. But even if it is, should this field of taxation be further invaded by the Federal Government to the exclusion of the States?

ECONOMIC EFFECTS

We cannot accept the theory that a large fortune is a public menace to be destroyed by taxes when its holder dies. Many such fortunes pass into the hands of excellent custodians who employ them constructively. To the extent that the desire to assure continuance in a family of the possession and development of a going business is a strong inducement to the hard application of energy and prudent administration of affairs, the knowledge that estate and inheritance taxes will defeat such a purpose would mean inevitably a lessening of incentive upon the part of men of ability. They would be unwilling also to lend themselves to the establishment of new enterprises.

There are many instances throughout the country of the employment of fortunes in such a manner as to assure and increase employment, stimulate the development of whole sections or an entire community, and increase efficiency in production and trade with benefits to consumers.

Even under present taxes we hear from trust officers and insurance experts of instances in which they are asked to devise a plan whereby a man still in the prime of life who possesses considerable funds, may in effect disburse the principal over a period of time estimated to cover his remaining life and to leave his one or two heirs with only a portion of the fortune. The motive behind that desire is explained as resentment against what he considers confiscatory death dues with lack of incentive to augment the fortune. He is unwilling to see it absorbed in taxes, preferring to make gifts to tax-exempt recipients or to spend the money often abroad. Thus it is obvious that taxes and the attitude of individuals toward them can result in the dissipation of wealth, in extravagance, or in other decisions that may be considered in effect antisocial.

Any large fortune (although it must be noted that the schedules in the bill do not deal solely with large bequests) passing to one who in the correct sense is not a good custodian of wealth—with ability to preserve it—works its own cure. It disappears. The old saying of three generations from shirt sleeves to shirt sleeves is often now proving to be a liberal estimate of time. That saying was generally used to refer to personal incapacity to preserve or augment fortunes. Under present conditions the second generation, due to the rates of estate and inheritance taxes and methods of applying them, in the face of shrinkage in values, may become possessed of little, if any, wealth.

In this connection I make bold to say that the best justification of a capitalistic system is the fact that, by and large, wealth tends to come into the possession of people who are the best custodians of it. By good custodianship is meant a constructive employment of the wealth. Pools of wealth in the hands of capable individuals who can apply their ability and energy, in addition to their resources, make for economic development. It is largely to the men of means and income to whom business must now look for the funds to strengthen weakened financial and business institutions and to develop new enterprises.

We should make clear that while the general proposal respecting the levy of the high inheritance tax is opposed by us, and, we believe, should be opposed by everyone, our attitude is not because of the circumstance that few or many persons may be involved directly, but because of the harmful effects upon enterprise and the general economy and especially upon business undertakings. If estate and inheritance taxes, combined with income taxes, should remove the incentive to thrift and endeavor, an economic injury, not a benefit, must result.

If the public understands that the adoption of the inheritance tax scheme will in practice amount to confiscation, a feeling of unfairness will rapidly grow.

It should be remembered that inheritance and estate taxes are by nature fortuitous. Estates and bequests may be subject to one rate of taxes this year and the estate and bequests of the next year or of the year after may be subjected to a different rate. In addition, the impacts of such taxes are adventitious in that asset values increase or decrease from year to year because of general economic conditions or special market situations. These taxes are not levied with attention to the income earning powers of the principal sums involved. They are capital taxes in effect. They reduce the corpus of an estate usually in such a manner as to bring into Government treasuries cash that thereafter for a considerable time, as a rule, produces no taxable income, certainly not while it is in the possession of Government. This argues that the rates of death dues should be kept stable.

The records indicate that a very high percentage of the estates of \$1,000,000 or more do not have cash and other liquid assets averaging more than 11 percent. For the most part the money is invested in going businesses, not in tax-exempt bonds or preferred stock but to a very considerable extent in partnership enterprises, common stockholdings, or the sole ownership of income-producing properties or enterprises. The question then arises—by what means or process will Government collect such a combination of estate and inheritance taxes as has been suggested? Because the taxes would represent such a very large proportion of the total value, there can be no expectation of defraying them from current earnings in any reasonable period. To spread the period of the payment of the estate or inheritance taxes over many years obviously would reduce the immediate yield to the Government and raise such difficult questions as payment of interest. To attempt to sell large blocks of stock or other securities on the market, we have seen even under existing taxes, can result either in a glut with no sales or sales at depressed values, without even a sufficient amount realizable to pay the tax. In the case of some of the notably large holdings in corporations it is an absurdity to speak of issuing bonds in sufficient amount to defray the estate and inheritance taxes, if the House bill passes.

In the case of fortunes actively engaged in enterprises it may be asserted that a corporation could be organized to take over the interests of the estate. It would seem, however, that such a corporation to be able to do this must be as large or larger than the estate itself. Even if this method would realize the Government's money at the expense of the estate and its beneficiaries, the result clearly would be contrary to any purpose of the proposals that might contemplate the use of such method of taxation to break up large aggregations of capital.

Can we afford in such a period as now exists, no matter what may be advanced in the way of argument as to social purpose or other justification, to discourage the enterprise of living people, cause shut-downs of active businesses or violent changes in ownership through forced transfers to obtain some taxes from an inheritance tax plan, which if devised with all caution can produce under the fiscal conditions likely to exist during the next few years but a very small proportion of the Government's total revenues?

INSURANCE

The bill specifically provides (sec. 203-a-5 and 7) that the proceeds of insurance policies upon the life of a decedent, even though at the time of his death he did not have the right to change the beneficiary or have any legal incident of ownership, are to be treated as a taxable transfer.

Such a fortuitous tax as an estate, or an inheritance tax, which is bound to a large extent to be an incursion into capital and cannot be paid out of income, should be permitted to be insured against.

If in addition to other resources, a man has a business in which he has invested \$1,000,000, and in the interest of continuing it as a going business desires to leave that business intact to his son, his resources over and above that investment must be an additional \$1,200,000. In other words, it would be necessary to leave the son a bequest of \$2,200,000 in order to pass the business on to him.

If the business is virtually his entire fortune, as is frequently the case, and he sought to leave it intact to his son, by adding to his estate the proceeds of an insurance policy to the amount of \$1,200,000, he probably could not do it. The premium on an ordinary life policy, about \$50 per thousand, would mean an annual cost of \$60,000 which would mean 6 percent on the million dollars invested in the business. If, however, the law exempted from estate and inheritance taxes the proceeds from insurance policies up to the amount of the tax, he would have to carry only \$413,000 insurance—the amount of the tax on a million dollars bequest. The premium on such an amount of insurance presumably would be within his financial capacity.

The estate by transfer tax and inheritance tax are now the principal items among emergency expenditures incident to death. Physical properties, and securities both liquid and slow, make up the great bulk of the estate of decedents. It is always extremely difficult to realize quickly from the assets of the normal estate the considerable sums of money that are required to meet obligations. In the case of a large tax obligation imposed fortuitously by death, realization becomes even more difficult. The taxes deplete the estates not only by reason of the levies, but by reason of the sacrifice incident to the process of raising the money required to pay the tax.

It would seem that individuals should be permitted to insure against death dues as against fire, tornado, or other damaging visitations upon property.

In many situations, if insurance is taxable, no form of protection against disastrous impacts of death dues can be provided. Reference has been made to some of these situations, but to make it clear an illustration might be given of a net estate of \$10,000,000 against which there would a gross estate tax of \$4,416,600. If the proceeds of any life insurance which might be added to this estate were also taxable, at the maximum rate of 60 percent, it would require \$10,940,150 of insurance to pay the Federal estate tax alone on such an estate. This would involve an annual premium of approximately \$550,000. In other words, the cost of insurance would absorb the entire income of the estate at 5½ percent. If, however, it were only necessary to raise through tax-exempt insurance the amount of \$4,416,600 of tax, the annual premium therefore would be approximately \$220,000 and leave about half of the income of the estate to the owner.

Even though the premiums of such amounts of insurance be within an owner's ability to pay, such an amount of insurance may not be available. Besides having definite limits upon the amount of risk which it will assume on any life, every company, in passing upon applications, takes into consideration the total of insurance in force and being presently issued, in all companies, and its relation to the financial worth of the insured, as well as the total amount of premiums being paid or presently payable on such issuances, and its relation to the insured's income. In practice, the aggregate amount of insurance procurable is approximately 10 times one's income at the younger ages, reducing to 2½ to 3 times the income at the older ages. This would be the aggregate amount procurable on any life in all companies, even assuming the widest possible distribution through reinsurance and otherwise. A few hundred thousands of life insurance is perhaps the maximum amount which actually is written on any one life under ordinary circumstances.

Before life insurance payable to designated individual beneficiaries was subject to tax—as well as subsequently, before the tax became so burdensome—taxpayers did provide for death dues through life insurance. It seems manifestly in the public interest to enable them to do so to the limit of their ability. The Government is benefited by prompt payment of taxes. The estate is enabled to pay the tax without sacrifice of assets. Business is not disturbed by avoidable economic

distress due to the tax. Employment continues uninterrupted by conditions attributable to the tax.

In order to mitigate the hardship of their succession duties, seven or eight provinces of Canada have recently incorporated in their revenue laws provisions for the exemption of life insurance in amounts equal to such taxes, if made payable to the Provincial Treasury, or to the executor and ear-marked for payment of such taxes. We present below various provisions of law on this point as adopted in Canadian provinces, as well as a compilation of the provisions of the laws of our States with respect to taxation of the proceeds of insurance.

TAXATION OF LIFE-INSURANCE PROCEEDS PAYABLE TO BENEFICIARIES OTHER THAN INSURED'S ESTATE UNDER STATE INHERITANCE AND ESTATE TAX LAWS

The general rule to which most of our States still adhere is that the proceeds of life insurance payable to designated beneficiaries is not subject to the State inheritance tax. It is true, however, that many of the States following that general rule have an estate tax for the purpose of obtaining for the State the benefit of the 80-percent credit allowed against the Federal estate tax, and under these provisions life-insurance proceeds may be subject to tax without increasing the aggregate amount of tax, because the part that otherwise would go to the Federal Government goes to the State government.

The States which specifically and primarily tax the proceeds of life insurance payable to designated beneficiaries with varying specific exemptions are: Arkansas, California, Colorado, Mississippi, Montana, New York, North Carolina, North Dakota, Oklahoma, Tennessee, Washington, and Wisconsin.

There is annexed a chart which indicates more specifically the situation in each of the States.

TAXATION OF LIFE INSURANCE PAYABLE TO ESTATE OF INSURED UNDER STATE INHERITANCE AND ESTATE TAX LAWS

The general rule is that in States imposing an inheritance or estate tax, or both, policy proceeds payable to the insured's estate must be included in the gross estate for taxation without the benefit of any specific exemptions. In the following States there are these exceptions.

Kansas.—No taxation, if used to pay inheritance tax under following statute as interpreted by administrative officials.

Section 79-1508—1923 Revised Statutes of Kansas as amended:

"Provision in instrument for payment of tax on gift out of other property.—When provision is made by any will or other instrument for payment of the legacy or succession tax upon any gift thereby made out of any property other than that so given, no tax shall be chargeable upon any money to be applied in payment of such tax. (L. 1915, ch. 357, sec. 8; April 10.)"

Maine.—No taxation under inheritance tax laws if proceeds pass to widow, widower, or child under insured's will or State intestacy laws.

North Dakota.—The statutory exemption of \$20,000 seemingly applies to proceeds payable to insured's estate.

Texas.—If premiums were paid by community funds, only one-half of proceeds are taxed under inheritance tax laws.

APPLICATION OF CANADIAN PROVINCIAL SUCCESSION DUTIES TO LIFE-INSURANCE PROCEEDS

The statutes of the following Provinces have been examined: Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Prince Edward Island, Quebec, Saskatchewan, Yukon Territory.

Without exception the succession duties in all these Provinces are applicable to the proceeds of life insurance, though an individual beneficiary be designated. In certain of them, British Columbia, Manitoba, Nova Scotia, Saskatchewan, and Yukon Territory, there are, however, specific exemptions of limited amounts of life insurance payable to certain close relatives, the largest of which specific exemptions is \$25,000 in British Columbia. In none of the other Provinces does the specific exemption exceed \$10,000.

In all of these Provinces, however, with the exception of British Columbia and Quebec, there is a specific exemption in varying verbiage, of the amount of life insurance dedicated and actually applied to the payment of succession duties. In Quebec the same result would seem to be reached by a general provision

permitting the deduction for succession duty purposes, from the proceeds of life insurance, of any "debts or charges" which a gratuitous beneficiary is legally bound to pay from the proceeds. The following are some of the varying forms of statement of the exemption:

Alberta—Section 7. "No duty shall be payable on or in respect of * * * (e) insurance moneys, being the amount of any life-insurance policy effected by a deceased person on his life, and expressly earmarked for the purpose of paying duty imposed by this act, except as to any excess of those moneys over the amount of the duty; * * *"

Manitoba.—Section 6. "No duty shall be payable on or in respect of * * * (e) the amount of life insurance effected by deceased on his life and expressly made payable to the Minister or an executor or trustee for the purpose of paying duty imposed by this Act and applied for that purpose, if it be paid to the Minister on his demand therefor; * * *"

Ontario.—Section 6 (2). "Property passing on the death of the deceased shall be deemed to include for all purposes of this Act the following property * * * (g) The premiums paid on that portion of a policy of insurance applied to the payment of duty where such policy of insurance is made payable to the estate of the deceased in trust for the Treasurer for the purpose of providing money necessary to pay the duty on the estate of the deceased, whether originally issued or subsequently endorsed for such purpose, but notwithstanding anything herein contained, moneys received by the Treasurer on such last-mentioned policy and applied by him in full of or on account of the Ontario Duty shall not be deemed to be property passing on the death of the deceased and duty shall not be payable thereon; * * *." (The Ontario provision for including the premiums paid on such a policy, in property subject to the duty, is peculiar to Ontario.)

Saskatchewan.—Section 7. "No duty shall be leviable * * * (c) on moneys receivable under a contract of insurance, effected by a deceased person on his life, and expressly made payable to the Provincial Treasurer, for the purpose of paying the duty imposed by this Act, or in respect of the succession to such moneys, except as to any excess thereof over and above the amount of the duty, which excess, received by the Provincial Treasurer, shall be accounted for by him to the persons entitled thereto; * * *."

Taxation of life insurance payable to beneficiaries other than insured's estate under State inheritance and estate-tax laws

[“X” indicates an exemption or taxability for reason stated at head of column]

States	No death taxes	Proceeds exempt because—		Proceeds taxed because of—	
		Express exemption	No taxing provision	80 percent Federal credit statute	Other statute exemptions inheritance or estate
Alabama.....				X	
Arizona.....			X		
Arkansas.....					X. ¹
California.....					X. ² \$50,000.
Colorado.....				X	X. ³ \$75,000. ⁴
Connecticut.....		X ⁶		X	\$40,000. ⁵
Delaware.....		X ⁶		X	
District of Columbia.....	X				
Florida.....				X	
Georgia.....				X	
Idaho.....			X		
Illinois.....			X		
Indiana.....		X ⁶		X	
Iowa.....				X	
Kansas.....				X	
Kentucky.....		X			
Louisiana.....				X	
Maine.....				X	
Maryland.....				X	
Massachusetts.....				X	
Michigan.....				X	
Minnesota.....				X	
Mississippi.....					X. ⁷ \$20,000.
Missouri.....				X	

See footnotes at end of table.

Taxation of life insurance payable to beneficiaries other than insured's estate under State inheritance and estate-tax laws—Continued

["X" indicates an exemption or taxability for reason stated at head of column]

States	No death taxes	Proceeds exempt because—		Proceeds taxed because of—	
		Express exemption	No taxing provision	80 percent Federal credit statute	Other statute exemptions inheritance or estate
Montana.....				X	
Nebraska.....				X	X. \$50,000.
Nevada.....	X				
New Hampshire.....				X	
New Jersey.....				X	
New Mexico.....			X		
New York.....				X	X. \$40,000. ⁸
North Carolina.....				X	X. \$20,000. ⁹
North Dakota.....					X. \$20,000.
Ohio.....				X	
Oklahoma.....				X	X. \$20,000. ¹⁰
Oregon.....		X			
Pennsylvania.....		X ⁶		X	
Rhode Island.....				X	
South Carolina.....			X		
South Dakota.....			X		
Tennessee.....					
Texas.....				X	X. \$40,000. ¹¹
Utah.....			X	X	
Vermont.....				X	
Virginia.....				X	
Washington.....				X	X. \$40,000. ¹²
West Virginia.....				X	
Wisconsin.....				X	X. ¹³
Wyoming.....		X			

¹ Proceeds payable to direct descendants or ascendants or widow exempt. All other proceeds taxed except where based on valuable consideration.

² Proceeds not taxed where insured has relinquished right to change beneficiary or secure cash value before June 25, 1935.

³ Proceeds taxed only where insured took out policy on own life and reserved the right to change beneficiary.

⁴ This exemption allowed against inheritance tax.

⁵ This exemption allowed against estate tax which applies to net estates over \$250,000.

⁶ Under inheritance-tax law only.

⁷ Insurance not taxed in practice.

⁸ Additional exemption allowed of differences between personal exemptions (\$20,000 to spouse or \$5,000 to each child) and sum of \$100,000 taken off first tax bracket of 1 percent.

⁹ Exemption allowed only to lineal issue, lineal ancestor, husband or wife or stepchild. Policies on which insured did not pay premiums are exempt in any event.

¹⁰ Proceeds are not taxable if policies not taken out by insured or he has not reserved right to change beneficiary.

¹¹ \$40,000 exemption allowed only to husband, wife, son, daughter, lineal ancestor or descendant, legally adopted child or lineal descendant of such adopted child.

¹² Certain "business" policies exempt to extent of cash value immediately prior to insured's death.

¹³ Proceeds not taxed if returned for income taxation or (?) where insured did not pay premiums directly or indirectly.

Senator KING. Are there any witnesses here from outside of Washington who are very anxious to get away tonight? If so, I will take them out of order and give them preference over Mr. Alvord, who is the next witness.

**STATEMENT OF WILLIAM W. SCHNEIDER, ST. LOUIS, MO.,
REPRESENTING MONSANTO CHEMICAL CO.**

Mr. SCHNEIDER. I have just one point to discuss in a three-point memorandum.

Senator KING. State your business and residence.

Mr. SCHNEIDER. Secretary of the Monsanto Chemical Co., of St. Louis, Mo.

Senator WALSH. Are you here in a personal capacity or representing that company?

Mr. SCHNEIDER. The secretary, representing that company.

The amendment herein suggested is prompted by the recommendations in the President's message to impose "a tax on dividends received by corporations", and to ultimately "seek through taxation the simplification of our corporate structures through the elimination of unnecessary holding companies in all lines of business".

If it be the policy of the administration, and of the Congress, to simplify corporate structures along lines indicated by recommendations in the President's message on taxation, I desire to present suggestions for your consideration whereby this end may be encouraged without imposing undue burdens upon legitimate industry and at the same time the revenues of the Government may be safeguarded adequately.

There doubtless are many corporations in the country in the position of the Monsanto Chemical Co., for which I speak. We are both an operating company and a holding company. This position has been reached by us as a result of expansion by acquisition of other companies in order to attain a balanced production in the industrial chemical field. Chemical production is a constantly changing science. Change may wipe out suddenly a concern confined to a few narrow lines. Our company spends about \$1,000,000 a year in the aggregate in research for new methods, new products, and new uses; and it is said that 4 percent of the sales of the entire chemical industry is expended in research annually.

Reorganization into a single operating unit, if possible, might be desirable in our case, and probably in many cases, if by so doing severe tax penalties would not be incurred. Our present structure is not due to tax avoidance; certainly it is not tax evasion. But it was built upon the existing laws as a matter of convenience and sometimes almost of necessity as conditions then existed. If we had faced the certainty of heavy income-tax liabilities or other taxes we would not have paid some of the prices involved in acquisitions, but would have discounted the price to meet these liabilities or we would have dropped the deals.

If it is to be the policy to discourage holding companies or to tax dividends paid by a subsidiary to its parent or holding company, then we suggest that holding companies first be given the opportunity voluntarily to convert themselves into operating companies by taking over and operating the business and property of their subsidiaries, without subjecting themselves to penalties or heavy income tax liabilities.

Senator KING. You do not believe the tax bill ought to be a bill to compel corporations to dissolve?

Mr. SCHNEIDER. If they do, then the corporations should first have the chance to convert themselves into operating companies.

Senator KING. Proceed.

Mr. SCHNEIDER. Even if no tax on intercompany dividends be imposed, it is suggested that the simplification of corporate structures be encouraged by allowing holding companies to take over and directly operate the business and property of their subsidiaries without, in so doing, incurring a heavy income tax liability.

We will cite the case of our own company as an illustration. No doubt there are others in the country similarly situated.

Monsanto Chemical Co. originally was solely an operating company, owning and operating two manufacturing plants in the Middle West. We desired to balance our business and stabilize it. As we grew and expanded our business we acquired other companies through cash purchases and exchanges of stock. At the present time, in addition to owning and operating our two original manufacturing plants in the Middle West, we own the capital stock of Massachusetts, Alabama, Ohio, Virginia, and other State corporations which operate plants in six different States.

Senator KING. Engaged in the same line of business?

Mr. SCHNEIDER. The same general line of business.

Senator KING. In so doing you avoid transportation? It would not cost you so much to ship from St. Louis to Alabama?

Mr. SCHNEIDER. That is one of the reasons.

Senator KING. If the commodities were used in Alabama and you had a plant there, you would avoid the cost of transportation.

Mr. SCHNEIDER. And also, the plant was there when we bought it.

We desire to simplify our corporate structure and to transfer the business and assets of those subsidiary corporations to the parent company and have the parent company directly operate those other plants but cannot do so, without subjecting ourselves to heavy income tax liabilities. In other words, it appears that if we liquidate those subsidiaries and transfer their business and assets to the parent company, we would be receiving a liquidating dividend, which would be subject to income tax on the capital gain. When the capital stock of these subsidiaries was acquired, that was the simplest and most convenient manner of handling the transaction, without knowledge of a future proposal to tax dividends paid by such subsidiary to its parent company.

Therefore, we suggest an amendment which will allow a parent or holding company to take over and operate the business and assets of its subsidiary without the recognition, at that time, of any taxable gain or deductible loss, and that recognition of such taxable gain or deductible loss be postponed until such time as the business or property so taken over is sold to third parties or passes out of the ownership or control of the parent company, which latter provision would safeguard the Government's interests adequately. In such a transfer of property from subsidiary to parent company, there is only a technical or nominal change of ownership, and the business is continued to be operated for the benefit of the same ultimate parties, that is, the stockholders of the parent company.

In connection with the President's suggested tax on dividends and the simplification of corporate structures, it must be borne in mind that amalgamation with foreign subsidiaries is not possible.

Senator KING. When you use the word "foreign" do you mean interstate?

Mr. SCHNEIDER. I meant, for instance, European companies.

Therefore, we believe that if any consideration is given to a tax on intercompany dividends, it should not include a tax on dividends received from a foreign subsidiary because there is no practical way in which to merge or amalgamate such foreign subsidiary with an American corporation. Our company owns the common stock of a British corporation operating two plants in Great Britain and there is no way in which we can merge the British company with our company.

There are other cases in which a company owns less than the entire interest in another corporation and in which cases the taking over of the business and properties of such other company is not possible. We have reference to cases where two corporations, owned by different interests, form a third corporation to which each contributes something in a joint enterprise. A concrete example is a corporation to exploit the sale of a product for certain new purposes or uses, in which one corporation contributes patents covering such uses or purposes and the other corporation contributes the manufactured product.

In the foregoing, we are not approving or advocating a tax on inter-company dividends, but we are suggesting an equitable method of permitting the simplification of corporate structures, which simplification we believe will result if our suggested amendment is adopted. We therefore urge its adoption, regardless of whether any tax is levied on intercompany dividends.

Senator KING. Could there be this consolidation to which you refer, without great losses to the company or to the subsidiaries and to the parent company?

Mr. SCHNEIDER. If the assets and business of the subsidiaries are transferred to the parent company, there is a technical ownership, and in our case a taxable gain would accrue. I do not know what the figures would be. It might be close to \$500,000; although there is no real change in ownership. The same interests would operate the companies, and it would be for the benefit of the same parties.

Senator WALSH. You mean losses other than taxes?

Senator KING. Yes. In effecting the change.

Mr. SCHNEIDER. I do not believe there would be any losses.

Senator KING. If you have half a dozen companies and you do not own all of the stock, but you own a preponderating influence and you seek to consolidate it all into one, would there not be losses?

Mr. SCHNEIDER. In our case there would not be. I do not believe we could consolidate companies in which we do not own the entire interest, because the other parties would not be agreeable to it.

Senator GORE. That only illustrates one difficulty of levying a tax which may involve a reconstruction of various corporations as an incident; corporations which are proper and legal.

Mr. SCHNEIDER. As I say, Senator, when we entered into these transactions, there was no knowledge that any such proposal would be made, any social reform measure, if you might term it such. My point is, if there is to be any such action, we should first have the opportunity to meet it.

Senator GORE. You are exercising what was a legal right at the time?

Mr. SCHNEIDER. Yes, sir. Based on the laws as they then existed.

**STATEMENT OF GEORGE O. MAY, NEW YORK, N. Y., SENIOR
PARTNER OF THE FIRM OF PRICE, WATERHOUSE & CO.**

Senator KING. Will you state the capacity in which you appear, Mr. May?

Mr. MAY. I appear as an individual, primarily due to my interest in tax matters. I was connected with the Treasury during the war and later was a member of the Joint Congressional Committee on Taxation. I am senior partner in the firm of Price, Waterhouse & Co.

I wish to speak very briefly on the question of the effect of the proposed taxes added to the existing taxes upon those not directly subject thereto. I do not propose to touch on the effect on the persons subjected to the tax except insofar as that is necessary to indicate the probable effect on the great majority of our population who will not be directly subject thereto. It is generally recognized that one of the most vital needs of an industrial community is an adequate supply of capital to be invested in new enterprises.

A little thought will convince that to keep our people busy, development of new industries must be on a constantly increasing scale. In the next generation, we must create new industries exceeding in magnitude the motor, radio, and other industries created during the last 30 years. Now, in the course of such development large losses of capital will be incurred. Professor Allyn Young, one of our greatest economists, used to say that he doubted whether, taking all enterprises together, there was such a thing as profit; that losses equaled profit over a reasonable rate of interest. The important consideration for our people is what effect the proposed taxes will have on the supply of capital for these purposes. Obviously, this phase of the case is far more important than the amount of revenue which is expected to be derived therefrom.

In a generation, according to the Treasury's estimates, that yield would not be greatly in excess of the deficit for the last year. Economists, even those who favor practically confiscatory taxes on wealth, recognize that such taxation will destroy the principal source of capital for new enterprises and that if the community is to continue to exist in anything like the present scale of living, a new source for such capital must be found.

So far as I am aware, no study of the effects of such legislation on the supply of capital has been submitted to the Congress or any of its committees. The subject was very exhaustively studied over a period of 2 years by an English committee on national debt and taxation headed by Lord Colwyn, which made a report dated November 15, 1926, which is rated, I believe, as perhaps the most authoritative pronouncement on the subject available.

Senator KING. Do you know whether our committee, of which Mr. Parker is a member, and who made a rather extensive study of the taxation system in Great Britain, took cognizance of Lord Colwyn's report?

Mr. MAY. I have not had the pleasure of seeing Mr. Parker since that report was made; I could not tell. I have a copy of it here if you would like me to leave it.

Senator KING. I wish you would leave it with the secretary. I would like to examine it.

Senator GORE. How large is it? Could it go in the record?

Mr. MAY. It is a very big document [handing volume to Senator King].

Senator KING. Is that the only copy you have?

Mr. MAY. I have another one in my office.

Senator KING. Have you any objection to leaving that with the committee?

Mr. MAY. I would be very pleased to leave it.

Senator KING. Thank you.

Mr. MAY. This report is regarded as perhaps the most authoritative pronouncement on the subject available.

They started, as I do, with the assumption that graduated income taxes and inheritance or estate taxes were necessary and proper, and that the limits on such taxes should be either the limit of ability to collect them or the limit at which the injury to the community would be greater than could be compensated by the collections. In the course of the report they said:

Money in the free disposition of the citizen has a utility to the State as well as to himself. Saved and invested, it supplies the financial and industrial needs of the community. The special utility to the community only begins when the greatest utility to the individual has ceased. The larger the income, the more room is there for savings; and the State, when putting a heavy tax on incomes with the greater margin, has to consider the risk of doing too much damage to savings.

And elsewhere they said that the effect of an estate tax was substantially the same.

Again they said:

Any taxation which unduly diminishes the reward of entrepreneurs for taking pioneer risks is in that respect a source of harm to the community.

At the time when the report was written, the maximum rate of income and supertax was 50 percent and the maximum rate of estate tax was 40 percent to which was added an inheritance tax which, in the case of direct descendants, was only 1 percent and in no case exceeded 10 percent. That is the same as today.

In their conclusion, the committee stated:

We conclude, with regard to the supply of capital from individual and corporate savings, that industry has suffered materially from the effect of high income tax and super-tax. This remains true, when full allowance has been made for the proportionate application of revenue to the large payments on account of the national debt which accrue directly or indirectly to the benefit of trade.

Of course, under the present proposals, there would be no compensating benefit from the reduction of the national debt.

Everyone realizes what a problem the proposed taxes would create in a case such as that of Henry Ford, but it is a gross mistake to assume that the difficulties would arise in only a few extreme cases like his.

I notice that Mr. Jackson, in his testimony yesterday, estimated the value of Mr. Ford's holding in Ford Motor stock at \$354,000,000. He said, quite fairly, that that was an exceptional case, but I think that in fairness he should have added that substantially similar results would ensue if the figures were only a tenth of those assumed by him.

In fact, they would be almost confiscatory if the figures were reduced to a bare 1 percent of the figures in the Ford case. Since reading his testimony in the press, I have made a comparative table showing the results of the application of the proposed taxes to a case similar to that of Mr. Ford, using, first, values of \$350,000,000; second, values of \$35,000,000; and third, values of \$3,500,000, the last being 1 percent of the Ford figures, roughly.

They show that if Mr. Ford left stock in the Ford Motor Co. having a value of \$350,000,000 to his son, and the estate and inheritance taxes were payable over 10 years, without interest, and the stock received by Mr. Edsel Ford paid 10-percent dividends annually, the net yield of those dividends, after deducting the proposed surtaxes, would amount to only 28 percent of the annual installment of one-tenth payable on the taxes.

I think that is a point that was not clearly made in Mr. Osgood's presentation. He overlooked the fact that the tax would fall on the beneficiary and not on the Ford Motor Car Co., and you could only raise money on the stock, and you could only get money to pay the tax by dividends on the stock, and those dividends would be subject to these heavy surtaxes.

I have the table here; you might be interested to see the figures. (The table referred to is as follows:)

Statement showing effect of existing estate tax and proposed inheritance tax on an estate consisting of stock of a corporation left to a single beneficiary (son), assuming the value of the estate to be (A) \$350,000,000, (B) \$35,000,000, and (C) \$3,500,000, and assuming (1) that the taxes could be paid in 10 annual installments and (2) that dividends on the stock may be expected at the rate of 10 percent per annum on the valuation, and that the proposed surtax rates will be payable thereon (State taxes and interest on deferred payments of estate and inheritance taxes ignored).

(A) Valuation of estate.....	\$350, 000, 000
Estate and inheritance taxes thereon.....	312, 970, 750
Annual installment of tax, $\frac{1}{10}$	31, 297, 075
Annual dividends.....	35, 000, 000
Surtax thereon.....	26, 091, 000
Balance for payment of estate and inheritance taxes.....	8, 909, 000
Percent of estate and inheritance taxes that could be paid out of dividends annually.....	2.8
(B) Valuation of estate.....	35, 000, 000
Estate and inheritance taxes thereon.....	29, 470, 750
Annual installment of tax, $\frac{1}{10}$	2, 947, 075
Annual dividends.....	3, 500, 000
Surtax thereon.....	2, 481, 000
Balance for payment of estate and inheritance taxes.....	1, 019, 000
Percent of estate and inheritance taxes that could be paid out of dividends annually.....	3.5
(C) Valuation of estate.....	3, 500, 000
Estate and inheritance taxes thereon.....	2, 031, 168
Annual installment of tax, $\frac{1}{10}$	203, 116
Annual dividends.....	350, 000
Surtax thereon.....	185, 000
Balance for payment of estate and inheritance taxes.....	165, 000
Percent of estate and inheritance taxes that could be paid out of dividends annually.....	8.1

Mr. MAY. Briefly summarizing this statement, the valuation of the estate is \$350,000,000; estate and inheritance tax thereon, \$312,900,000; the annual installment of the tax, one-tenth, \$31,297,000; annual dividends, \$35,000,000; surtaxes thereon, \$26,000,000; leaves a balance for the estate and inheritance taxes of \$8,900,000, which is 2.8 percent of the total charges, or 28 percent of the annual installment of the tax.

Senator KING. Did you take into consideration the taxes that might be imposed in the various States?

Mr. MAY. I have left out the State taxes, interest on deferred tax, and everything of that kind.

Senator KING. If they paid all of those, there would be nothing left.

Mr. MAY. When you get to 2.8 percent, it does not make very much difference about the rest. It amounts to practical confiscation.

Senator GERRY. Was there not a suggestion made in the House in the hearings, if I recollect, that it can be worked out of income?

Mr. MAY. I believe Mr. Jackson did make that statement. But you see what that involves. You work it backward. You have, roughly, \$31,000,000 of an annual installment to pay, and if you are going to pay that out of dividends, you have to have enough dividends to pay 75-percent surtax and still have \$31,000,000 left, and that means you have to have four times \$31,000,000 in dividends, and that is \$124,000,000 in dividends on the stock valued at \$350,000,000, or, roughly, 35 percent.

If a stock was going to pay 35 percent, you would not get the Treasury to value it at par. I think you would have difficulty in getting them to value it at 10 times the annual earnings, which is the figure I have used in my calculations.

But as I say, that is a quite exceptional case, and that might be dealt with as a special situation; but when you divide the figures by 10 and come down to \$35,000,000, you find that after the dividends have been paid and the surtaxes deducted, what is left is no more than 3.5 percent on the amount of the tax. So that if the tax was paid over 10 years, it would only be 35 percent of the annual installment of the tax.

And finally, if you get down to an estate which is 1 percent of the size of Mr. Ford's—

Senator KING (interposing). That is, three and a half million?

Mr. MAY. Yes. The annual installment of tax would be \$203,000, and the balance that would remain out of the dividends after paying the surtaxes would be \$165,000. So you would be able to pay 80 percent of your annual installment, or 8 percent of the total taxes. Those are the figures in the case of a \$3,500,000 corporation.

Senator KING. Supposing you had no dividends?

Mr. MAY. Then you would be out of luck.

Mr. Jackson also said that he thought this could be financed by a bond issue, and people would be glad to finance a bond issue. On \$350,000,000, the taxes would be 89.5 percent.

Mr. Jackson's experience with underwriters may be more favorable, although I think it is probably less extensive than mine; but I have never found a bond house that was able to underwrite a bond issue for 90 percent of the value of the property, and I doubt if his hopes are well founded, and I doubt if anybody is going to try the experiment with a \$350,000,000 issue.

Senator GORE. Could we not tax these underwriters if they did not do it? [Laughter.]

Mr. MAY. If the figures were reduced, as I say, to one-tenth of the figures used in the Ford case, the percentage borne by the net income on the stock bequeathed to the annual installment of taxes would not rise to more than 35 percent; and even if the figures assumed are only 1 percent of those in the supposed Ford case, the income from the stock bequeathed would fall substantially short of paying the annual installment of the taxes. In either case of the first two assumed the beneficiary would be better advised to let the Government take the property for the taxes and buy it from the Government on the best terms he could get, rather than pay taxes amounting, as they would, to from 84 percent to 89.5 percent of the Treasury's valuation.

In the first two cases, the beneficiary would be in little better position to pay the tax if he owned large amounts of other property in addition, for 90 percent of all such additional property would be taken in taxes.

Further, in each of these cases a 10 percent overvaluation would make the tax practically 100 percent of the real value.

Another point I would like to make is that I do not believe that anybody could value the Ford estate holdings within a margin of 15 percent one way or other from a given figure, or a total spread of 30 percent.

If they put the valuation of that stock 10 percent too high and taxed it at 90 percent, that is 100 percent of the true valuation.

That I think is one of the great points that has perhaps not been as fully stressed before your committee as I would like to see it stressed, the importance of valuation in connection with this matter and the wide range of difference of opinion that exists in respect to valuation.

At this point I would like to quote some illustrations to show the difficulties of the problem of valuation. I would recall, first, a case in which I was personally concerned, in which the district court found as a fact and was upheld by the Circuit Court of Appeals in doing so, that the fair market value of an insurance stock was \$55 per share on the day on which it sold on the New York Stock Exchange at \$90, on the basis of which figure the Treasury proposed to tax the transaction.

In the case of the Tex-Penn Oil Co., the board of Tax Appeals said:

Our problem, then, at this point is to determine the "fair market value, if any" of the 1,007,834 share block of Transcontinental stock. In determining the deficiencies in these cases, the respondent used a fair market value of \$47.55. He has now abandoned that figure and asserts that the stock had a fair market value of \$12 per share * * * " * * * we have determined that the fair market value of the stock of Transcontinental Oil Co. received by petitioners in the transaction before us was \$7 per share."

Now, ignoring the Commissioner's first valuation in this case, it is obvious that a tax of 60 percent, let alone 90 percent, would amount to more than the total value found by the Board of Tax Appeals.

Another case which is perhaps pertinent is the case which involved the valuation of the Ford Motor Co. stock itself, the valuation of that stock as of March 1, 1913. In that case it was to the interest of the Government to put the value low. The Commissioner claimed that the value of the stock was \$3,547.84—marvelous accuracy—per share. Eventually the Board of Tax Appeals found that the tax value was \$10,000 a share or very nearly three times the figure fixed by the Commissioner.

The competent and honest estimates of the value of a business may vary 15 percent to 20 percent from a prior figure. To levy taxes which leave a residuum less than the reasonable margin of error is unsound taxation.

The report of the House hearings contains a copy of a letter written by the Chief of Staff of the Joint Committee on Internal Revenue Taxation suggesting extraordinary measures to meet the hardships imposed on the estates of decedents who died in 1929, because of changing values. That was under a statute levying a maximum tax of 20 percent. Even under that statute, it was frequently found to be impossible to collect the full tax so that valuation had to be arbitrarily reduced or compromise worked out. Under the proposed bill that would be the normal case in respect of any considerable estate.

The rates in the bill would in such cases be only nominally enforced. Taxation would, in fact, be at the discretion of the Treasury, as possibly limited by litigation.

I would like to draw attention to another consequence that would flow from such taxation, that is, that capitalists would be forced to spread their capital over numerous enterprises so as to avoid the effects that come if their capital is locked up in a single enterprise, with the result that our system of businesses owned by small private groups would disappear. The separation of beneficial ownership from control would be accelerated instead of being checked.

Senator GORE. That is the worse defect in our whole structure, as I see it now.

Mr. MAY. But the really vital objection to the measure is the effect it would have on savings and enterprise and, ultimately, upon employment and taxable income of the future.

It is difficult to see why capitalists should undertake new enterprises if the proposed burdens were added to the burdens of the existing laws, so long as any alternative might be open to them. Here there is the alternative of tax-exempt securities, which would at least avert surtaxes, and provide liquid funds to meet estate and inheritance taxes.

The disastrous effect of the general result now and on future enterprises is incalculable. To adopt the policy reflected in the bill without having first reviewed this alternative is rather like drawing water from a tested reservoir into a cistern known to be leaking, and to do so without providing some other source of capital seems to me with all respect to be improvident. I am reminded of the words of a great English economist, Alfred Marshall, referring to the social reformers who, as he put it, "in their desire to improve the distribution of wealth are reckless as to the effect of their schemes on the production of wealth."

Senator KING. Mr. May, please state for the record your experience in connection with taxation and revenue measures generally, and particularly measures relating to inheritance and estate taxes.

Mr. MAY. My experience has not been so much with inheritance and estate taxes, because they were not so active at the time that I was engaged, but I was in the Treasury during the war and I made a trip to England on one occasion at the request of the administration to study the English system while I was there and later I was a member of the Joint Congressional Committee, and I have been in consultation with the Treasury Department very freely during the last 20 years; in fact, the first contact I had was with the present Secretary of State when he drew the first income-tax bill, and I sat down with him and discussed the problems that presented.

Of course, in my business work I have a very close contact with taxation, although I do not specialize in it personally. That is handled by one of my partners, but I see it and its effects on business in a very decided way.

Senator KING. Price, Waterhouse & Co. has to do with estates and with business generally, and their accounts and investigations?

Mr. MAY. Oh, yes; we do a very large amount of accounting business in such fields.

Senator GORE. Mr. May, we have heard a good deal said about the sharing of the wealth. In all of what you and Mr. Osgood have said, don't you think that is rather conservative?

Mr. MAY. "Sharing" is not the word that I would have selected.

Senator GORE. That is the point.

Mr. MAY. I think it is an entire fallacy to believe that this would be a revenue producer, if you take account of the taxes that would be destroyed as well as the taxes that would be received. If you do that, I think it would be a net loser. The taxes that are received will show, they will show up in the return, and those that are lost will not be computed.

STATEMENT OF L. C. MORROW, NEW YORK, N. Y., REPRESENTING THE ASSOCIATED BUSINESS PAPERS, INC.

Senator KING. Your name and business, please?

Mr. MORROW. My name is L. C. Morrow. I am editor of the publication, *Factory Management and Maintenance*. I appear before you as a representative of the Associated Business Papers—a nonprofit organization of 127 of the Nation's leading business papers.

Senator KING. How much time do you want?

Mr. MORROW. Ten minutes.

Senator KING. Very well, proceed as rapidly as you can.

Mr. MORROW. These publications render a service of guidance and counsel to approximately 2,000,000 responsible businessmen. The publications, for which I speak, are, in every instance, national in circulation. Each seeks to be nonpartisan. Each seeks to understand and foster the public interest in serving its readers. In the same spirit we appear before you, seeking in such manner as we can to be of service in your present deliberations.

As a group we are of the opinion that a measure of such profound significance as this requires rather lengthy deliberation before enactment. Time is too short, for instance, for us to perfect the many suggestions that we should like to make out of our intimate understanding of the business situation and of the business mind.

Senator KING. What papers are those, may I inquire?

Mr. MORROW. They are the industrial and business publications of the country. There are 127 of them; I cannot give you a list.

Senator KING. One hundred and twenty-seven papers?

Mr. MORROW. One hundred and twenty-seven papers.

We do come to you, however, with one constructive proposal which we hope you may consider sound. Our proposal is that a further amendment to the Revenue Act of 1934 be considered simultaneously with proposed amendments represented by the present bill. Specifically we suggest that section 23 of the Revenue Act of 1934 be amended to read as follows [the amendment appears in italics]:

(L) Depreciation: A reasonable allowance for the exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence. *Under regulations prescribed by the Commissioner, with the approval of the Secretary, any person entitled to the benefits of this section may, during the taxable years ending after August 31, 1935, in lieu of the deductions permitted hereunder, elect to deduct in its entirety the full cost of any property actually acquired after September 1, 1935, and prior to December 31, 1936.* In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

Our motive in suggesting this amendment rests in the conviction that greater activity of our durable-goods industries is essential to recovery and that only through such activity can the tax-paying ability of the industry of the Nation, speaking broadly, be brought back satisfactorily.

Statistics compiled by Machinery and Allied Products Institute indicate that there is a deferred demand for durable goods amounting to not less than \$18,000,000,000 at the present time.

Senator GEORGE. Your suggestion is that that should apply to the expenditure to such property purchased?

Mr. MORROW. That expenditure for capital goods be written off during the year purchased rather than being amortized over a period of years, that is, rather than as now prescribed. Do I make myself clear?

Senator GEORGE. Yes. Purchased out of the earnings, or purchased out of current earnings, or out of accumulated earnings?

Mr. MORROW. Purchased either out of reserve or current earnings.

Senator KING. Or additional capital?

Mr. MORROW. We have not suggested anything about that. I see no reason why it could not be incorporated.

Senator KING. Proceed.

Mr. MORROW. Other estimates made by such experts as Col. Leonard P. Ayres place the accumulated demand for the products of durable goods at a figure as high as \$85,000,000,000—the approximate national income of the United States for 1929.

The publication, *American Machinist*, has recently conducted a survey of metal-working equipment now employed throughout industry. Its findings indicate that 65 percent of this equipment is more than 10 years old and therefore practically obsolete. These findings are supported further by detailed studies conducted by Dr. Frederick Dewhurst of the Twentieth Century Fund and published in *Iron Age* which show how much employment would be created in certain particular durable-goods industries if this deferred demand could be realized. Here are his figures expressed in the number of months of operation at the average 1923–28 rate of production that would be required to make good existing deficiencies:

	<i>Months</i>
Residential buildings	49
Freight cars	48
Industrial electrical locomotives	45
Woodworking machinery	44
Lead ore	43
Steel boilers	42
Track work	41
Electric overhead cranes	37
Electrical porcelain	33
Electric motors	32
Malleable castings	30
Pig iron	29
Industrial electric trunks and tractors	28
Steam power and centrifugal pumps	28
Fabricated steel plate	24
Steel sheets	24
Zinc	24
Steel ingots	23
Machine tools and forging machinery	21
Automobiles	19
Iron, steel, and heavy hardware	17
Cast-iron boilers	12

In terms of the national economy we believe—and statistics indicate—that the creation of employment is vitally necessary. Col. Leonard P. Ayres and Dr. Frederick Dewhurst have individually computed the amount of unemployment existing in durable goods industries and agree that, as of the end of 1934, when the rate of production of durable goods was essentially the same as it is at the present time, about 4,500,000 persons, or approximately 40 percent of those usually at work in these industries, were unemployed, as compared with only 1,300,000 out of work in consumer goods industries.

Colonel Ayres states the same conclusion in this way:

Finally the computations for this great depression show that unemployment among durable goods workers up to the end of 1934 amounted to 236.6 million worker-months, while that among makers of consumers' goods amounted to only 64.7 million worker-months.

We contend that the cost to Government, in relieving distress among unemployed, can be lessened to the extent that these workers can win back their old jobs. With approximately four times as many durable goods workers out of employment as consumer goods workers, the need for stimulating durable goods industries becomes self-evident.

It is our opinion that, if prospective purchasers of durable goods, who are now able to consummate such purchases, would be allowed to amortize investment of this kind immediately, charging such amortization to net income, a considerable stimulation of activity in durable goods would follow.

This conclusion is borne out by Germany's experience. To make this experience clear we quote Kenneth Condit, editor of *American Machinist*, who has recently explored the German situation:

During 1934 German manufacturers, by government decree, were permitted to write off at once sums expended for new equipment to replace obsolete equipment in their factories. It was required that the obsolete equipment be scrapped.

A similar provision applied to purchasers of automobile and agricultural implements and is still in effect according to the last information I received. The decree covering manufacturing equipment operated so successfully that it was withdrawn at the end of 1934 although machinery manufacturers were given until July 1, 1935, to fill orders.

The effect of this decree, coupled with various moves to limit profits, resulted in a very considerable stimulation of the equipment manufacturing industries. The machine tool industry in particular expanded its working hours from 40 to 48 per week and went to multiple shift operation. Practically all plants put on one extra shift and many were forced to put on two.

Senator KING. They exempted from taxation the amount that they applied to the purchase of new machinery?

Mr. MORROW. Yes; there were two classifications. One was for replacement machinery and the other was for entirely new machinery in additions to plant.

The indexes of durable goods production published by the League of Nations show that in early 1933 the German index stood at 58.5 whereas for March 1935 it stood at 91.4.

Figures for the United States indicate that in the corresponding 1933 period our durable goods activity stood at 44.7 of normal whereas at the end of March 1935 it stood at 64.5.

Senator GORE. How high did the German index run?

Mr. MORROW. 91.4 percent.

Senator GORE. Very well.

Mr. MORROW. Studies, based on 1929 census of manufactures and with wages figured at 1929 levels, show that of the dollar spent for machine tools 45 cents goes to wages, 29 cents goes to materials, and 26 cents to other expenses. In the manufacture of textile machinery 40 percent goes to wages, 31 percent to materials and 29 percent to other expenses. In the manufacture of electrical machinery 30 percent goes to wages, 39 percent to materials and 31 percent to other expenses.

Senator GEORGE. In connection with that, you of course would have no objection to a further provision that these permanent betterments and improvements and replacements be made by American-made goods?

Mr. MORROW. That is a point that our association has not considered. I think it is a point that should be considered, and well considered, before it is put into legislation. That is my personal opinion.

Senator GORE. If they could get it cheaper somewhere else, it would not do us any good.

Mr. MORROW. It ties in with our trade policy, of course.

Senator GEORGE. Yes. You may proceed.

Mr. MORROW. If the \$18,000,000,000 of deferred demand estimated by Machine & Allied Products Institute to exist at the present time for durable goods could be fully realized, an expenditure of \$5,880,000,000 in wages would follow, approximately \$8,000,000,000 would be paid out for materials. Assuming dividends might be earned at 5.5 percent, approximately \$987,000,000 would appear in the earnings statements of durable goods manufactures, which we all know are woefully low at this time.

It is to be borne in mind that stimulation of durable goods results in the payment of wages which buy the essentials of life, consisting mainly of consumer goods, as follows:

For the dollar earned 31.8 percent goes to food; 11.7 percent to clothing; 19.6 percent to housing; 5.3 percent to heat and light; 2.9 percent to furniture, while other items take 28.7 percent. It is to be borne in mind, further, that the full expenditure made for materials would embrace the same proportion of payroll and salaries. The cycle may be carried back to the mine, forest, farm—employment all the way.

We do not argue that the amendment we propose will, of itself, bring about the complete stimulation of durable goods industries that is so highly desirable in terms of the national economy. We do argue, however, that such a provision in the law would tend to encourage hesitant buyers to act at this time and assert that every move, which begets activity in this are of American business, constitutes a direct and welcome aid to recovery.

We would point out, in conclusion, that at time when 65 percent of our machine-tool facilities in this country are obsolete and when plant and other types of equipment also are in corresponding need of modernization, the situation in terms of national defense is not healthy.

We restate our position:

1. A healthy durable-goods industry is essential to recovery.
2. Manufacturers of durable goods can reemploy workers only as orders for what they make are received.

3. Expenditures for plant and equipment can, in many instances, best be made out of profits earned.

4. If investment in plant and equipment can be charged immediately to profit, business will be encouraged to purchase durable goods now.

5. The German experience indicates that the amendment advocated would prove effective in bringing about the end sought.

6. National-defense consideration make desirable the promotion of greatest possible degree of efficiency and the retention of the least possible amount of obsolete equipment and structure in American industry.

If it be true that business fears new and heavy taxes, if this fear results in a lack of confidence, then certainly a provision in a revenue law that tends to build earning power on a broader base should be worthy of consideration.

Senator GEORGE. Personally, I think your suggestions are highly constructive. It would help somewhat even if these replacements and permanent betterments could be made out of accumulated surpluses accumulated prior to some fixed date, for a period of time.

Senator LONERGAN. There is a gentleman here who said that he would take 8 or 10 minutes and would like to be heard, because he wants to catch a train.

Senator GEORGE (presiding). Senator King suggested that this be the last witness. Do you wish to get away, sir?

Mr. RIEHLE. Yes, sir.

Senator GEORGE. I hope you won't take longer than that. You may proceed.

**STATEMENT OF THEODORE M. RIEHLE, NEW YORK, N. Y.,
REPRESENTING THE NATIONAL ASSOCIATION OF LIFE UNDER-
WRITERS**

Mr. RIEHLE. My name is Theodore M. Riehle, president of the National Association of Life Underwriters, which is the organized agency forces of American Legal Reserve Life Insurance in the field, who meet the American public every day.

Senator LONERGAN. Where are you from?

Mr. RIEHLE. I am personally from New York. This is a national organization of all the legal reserve life insurance men in the field—estimated at approximately 200,000—who sell life insurance to the American public and meet them every day in their homes and in their offices.

Senator LONERGAN. We want to hear your story.

Mr. RIEHLE. It is with some temerity that I also say that to some extent—in fact, I feel in a very real sense—I also represent the buyers of American life insurance, and I say that because we are the ones in the life insurance business who come in daily personal contact frequently with the buying public, and therefore are familiar with their desires and needs. We have urged 63,000,000 American citizens to build up these accumulations, and we feel that we must come here and speak in their behalf.

My remarks will be addressed primarily to one subsection only of this entire bill, and that is subsection (a) (7) of section 203, which

provides for the taxability of the proceeds of life insurance under policies taken out by the decedent on his own life. And section 203 (a) (7) also provides for the taxability of such policies, even though at the time of decedent's death he did not have the right to change the beneficiary or have any legal incidents of ownership therein.

I am proceeding on the assumption, in order to tie the thing together intelligently and simply, that that section in its entirety should be eliminated for the reason that in our judgment——

Senator GORE (interposing). What section is that?

Mr. RIEHLE. Subsection (a) (7) of section 203, wherein the transfer of life insurance is attempted to be taxed in the hands of the beneficiary.

I make this now in the nature of a preface, because life insurance represents the replacement of income extended into the future upon the death of the breadwinner. It is a contract of indemnity against the loss of life values. Beneficiaries, in fact, suffer a loss far greater in value than the amount of the proceeds which they receive from life insurance as a replacement. There is no more serious thing than productive life losses, meaning the cutting off of earning power by death.

These are of both individual and social concern. The purchase of life insurance is not in the nature of a transaction for a profit or a loss. At the death of a policyholder his productive power is lost forever. All that life insurance does is to replace in part that which has been lost.

Senator KING. Is that quite accurate?

Mr. RIEHLE. I think it is definitely so.

Senator KING. Take a case of this kind, with which I am familiar. Mr. A, knowing that his widowed sister had no means of support, or rather limited means of support, and he having a great affection for her, took out a life insurance policy of considerable proportions in her behalf. She would never have received, if he had lived, anything approaching the amount of the policy which she received immediately upon his death. Can you say then that the thesis that you are suggesting is quite accurate?

Mr. RIEHLE. I think so, Senator, for the reason that in that case the possibility of her becoming a ward of charity was certainly remote, which point I cover just a little bit later.

Of course, the vast majority of life insurance is put into force in this country for family protection, primarily wives and children—the vast, vast percentage.

Because the loss of productive power, uncompensated, was intolerable, civilization developed life insurance. Partial replacement of the loss of character, industry, technical and managerial ability, power of initiative, and judgment of an individual, cannot be classified as creation of a property value in the usual sense.

The chief assets of the American people are their lives, their ability to work and earn a living. Life insurance seeks to replace these assets.

Its effect is to stabilize economic and hence social conditions.

American Legal Reserve Life insurance in the year 1934 distributed \$2,700,000,000 and in the years 1929–34 inclusive distributed more than \$15,700,000,000 to the American people.

Senator GORE. In death losses?

Mr. RIEHLE. Death losses, cash surrender values, matured endowments, dividends, disability income, payments of double indemnity, and the like.

It has been said that direct payment of benefits under life insurance policies in 1934, in the United States, touched the lives of at least 21,000,000 human beings.

We feel that the attitude of Government toward life insurance should be one of utmost encouragement, insofar as taxing procedure is concerned.

Frankly, gentlemen, we consider it in the field, we who sell it and convince the people of their social obligations to their wives and children primarily, we consider it almost a holy thing, if I may be so bold as to say that.

And we say that the attitude of the Government toward life insurance should be one of utmost encouragement, insofar as taxing procedure is concerned, for the very definite reason that the purchase of life insurance is highly charged with the common welfare.

The 63,000,000 holders of life insurance and their beneficiaries—dependents, and loved ones—look to us to urge protection of the structure which they have been encouraged to build.

Senator KING. For my own information, state the number of policies which there are? You may have done so—and the average as to each policy?

Mr. RIEHLE. The average amount of insurance outstanding as related to the number of policies is nominal. The amount of insurance in force is approximately \$100,000,000,000.

Senator GORE. You say 63,000,000 policies outstanding. How many individuals would that represent?

Mr. RIEHLE. That is very difficult to say, Senator.

Senator GORE. I knew that, but I did not know but what it had been ascertained.

Mr. RIEHLE. That is very difficult to say.

Senator KING. You did not mean to say that there were 63,000,000 policies outstanding?

Mr. RIEHLE. Yes.

Senator GORE. I wanted to know how many policyholders. How many individuals that would represent? One individual may have several policies.

Mr. PARKER. My information was, Senator, that in a report that was written by the Joint Committee in 1929, that there were about 63,000,000 individual policyholders, and the number of policies in force exceeded 119,000,000.

Mr. RIEHLE. There are 63,000,000 policyholders.

Mr. PARKER. Is that different policyholders?

Mr. RIEHLE. Yes.

Senator GORE. Does that mean that one policyholder might hold several policies?

Mr. RIEHLE. Yes.

Senator GORE. I was trying to get at the number of individuals that held that number of policies.

Mr. RIEHLE. We feel that the Government must do nothing, even inferentially, to destroy a confident feeling of family responsibility on the part of its citizens.

Life insurance is of a nature peculiarly suited to family exigencies.

Always there has been the implication that the life-insurance contract is not subject to the same rules which govern other types of financial instruments. It has no parallel and few analogies in all the transactions of life.

The individual, who looking into the future realizes the risk of premature death and undertakes through life insurance to hedge the welfare of his family against that risk, is discharging his highest social obligations, and government should protect and not discourage his efforts.

Debts and claims against estates are universally allowed as deductions under inheritance-tax laws—including the present bill—before the imposition of the tax. Life insurance offsets one of the most compelling debts due at death—the continuation of support for dependents and the education of children—obligations which no true American would be willing to leave unpaid, even in case of premature death.

That is, (1) as to that section in its entirety and very briefly put; (2) there should at least be a specific exemption for life insurance.

We come to the second point, which is very brief. If for some reason section (a) (7) is not entirely eliminated, at least some special exemptions should be granted to each beneficiary of life-insurance proceeds similar to the exemption which has always been allowed to each estate under the existing Federal estate tax law. It would seem that possibly a larger exemption might be granted to near relatives than is allowed to remote beneficiaries.

The specific blanket exemptions which are allowed to each beneficiary constitute no answer to a request for specific exemptions to named beneficiaries of life insurance. A provision grouping insurance with other forms of property insofar as the blanket exemptions are concerned would certainly discourage the purchase of life insurance for family protection purposes, for fear of the incidence of the tax, even though the eventuality might be that the total beneficial interest would not exceed \$50,000.

The organization filing this memorandum, consisting of tens of thousands of life insurance fieldmen, in daily contact with hundreds of thousands of the American life insurance buying public, were it possible to produce them for oral testimony, could substantiate this position.

The third point is, the second part of this subsection (a) (7) has a provision the effect of which is to say that one can divest himself of ownership of any other kind of property than life insurance under this bill, but if he divests himself of life insurance, of all of the incidents of ownership, in spite of that, life insurance in the hands of the beneficiary would nevertheless be taxed under this measure, which of course is a distinct discrimination against life insurance.

I am hurrying rapidly because of the shortness of time, and I ask permission to file this memorandum on that point.

Senator KING. You may do so.

Mr. RIEHLE. Now, gentlemen, I have here a supplemental memorandum of the point that has come up in Congress, that life insurance earmarked for the purpose of paying inheritance taxes to this Government shall be itself exempt from tax.

Senator GORE. Do you think that is practical?

Mr. RIEHLE. Yes, sir.

Senator GORE. Have you an extra copy of that?

Mr. RIEHLE. There has already been filed with each member of this committee a copy of our memorandum filed before the members of the House Ways and Means Committee.

With your permission, Mr. Chairman, I will file again a copy of my remarks with your committee, and a copy of the particular remarks as to the exemption of life insurance ear-marked, and will in addition, with your permission, again, send one to each member of your committee, so that their knowledge and information will be complete.

Are there any questions?

Senator KING. I think you had better file your statement with the secretary, and he will distribute them to the committee.

(The extension of Mr. Riehle's remarks is as follows:)

Mr. RIEHLE. Life insurance proceeds should certainly not be taxed where all legal incidents of ownership have been relinquished prior to the decedent's death.

In the case of property other than life insurance an inheritance tax would not be imposed by this bill, if the decedent, during lifetime, has given up all right, title, and interest therein. Hence, if such tax is imposed in cases where an insured has relinquished all legal incidents of ownership in the policies, such a provision would result in gross injustice, discrimination, and unfairness to life insurance. Under any condition, life insurance proceeds should most certainly receive no less favorable treatment than any other form of property.

Under the present Federal gift tax law, in a case where all legal incidents of ownership in a life insurance policy are transferred by gift during the lifetime of the insured, the value for gift-tax purposes includes not only the cash value at the date of gift, but the present value of the death benefits expressed in the adjusted value of the insurance. Therefore, it would appear that if the entire death benefit is to be subjected again to inheritance tax, this would certainly result in double taxation and possibly triple taxation if the gift were of sufficient size.

Creating such discrimination between insurance and other forms of property might lead holders of insurance to consider the advantage of discontinuing or transferring their insurance, when it is singled out for such unusual burden as the imposition of cumulative taxes on the transfer.

Actual experience indicates beyond doubt that if such a provision were enacted into law, millions of dollars worth of life insurance would be canceled or switched into other forms of property or insurance, which would bear no more than the usual incidents of taxation. This practice would result in great loss to thousands of policyholders, cause serious confusion among the agents who originally placed the policies, and disturb the reserves which have been built up for the protection of these contracts. And after all is said and done, the Government will receive little or no increase in revenue from such a tax.

Life insurance is an important social-service enterprise and an economic device of far-reaching social significance.

The Government instead of repressing the growth of life insurance through taxation should adopt a policy encouraging the widest possible use of its beneficent protection among its citizens. A life insurance contract in itself constitutes a self-imposed tax upon the policyholder and his family, it being a present sacrifice to provide against the incidents of premature death and the partial replacement at that time of the loss of the life-value of the bread winner.

Life insurance not only benefits the entire community but relieves the State of the necessity of supporting large numbers who would be dependent upon charity.

We submit:

First, for reasons of public policy, the Government should hesitate to treat the receipt of life insurance proceeds as an object of taxation.

Second, if emergency or other considerations lead the Congress to impose taxation on such proceeds, the imposition should be accompanied by appropriate exemptions.

Third, most serious consequences would accompany any imposition which involves more burdensome treatment of the transfer of life-insurance proceeds than of the transfer of other types of property.

EXEMPTION OF SPECIAL FUNDS SET APART FOR PAYMENT OF TAXES

On account of increasing taxes at the present time, property owners are faced with a serious problem of providing cash for the payment of taxes which become charges upon their estates. This is true to a greater extent where an estate consists of property which may not have a ready market without loss of value, such as an interest in a partnership, stock in a closed corporation, and certain forms of real property. The owner of such an estate is most certainly in a very disadvantageous position in attempting to provide cash for the payment of the tax. To keep an estate in liquid condition entails considerable loss of income in most cases.

Naturally, the Government, the estate owner, and the beneficiaries desire prompt payment of such taxes, but there is no inducement to provide for prompt payment when a loss might be incurred, and, in addition, the entire fund itself is to be taxed at rates applicable to the higher brackets.

It is, therefore, recommended that consideration be given to the exemption from estate and inheritance taxes of funds provided by life insurance, or possibly otherwise, which are set apart and made available to the Government for prompt and immediate payment of such taxes when due.

(The memorandum submitted is as follows:)

MEMORANDUM FOR WAYS AND MEANS COMMITTEE OF THE HOUSE OF REPRESENTATIVES OF THE UNITED STATES CONGRESS BY THE LAW AND LEGISLATION COMMITTEE OF THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

On July 13, 1935, while Mr. Roy C. Osgood, vice president of the First National Bank of Chicago, in charge of trust department activities, was testifying before the Ways and Means Committee, Representative Vinson, of Kentucky, asked Mr. Osgood if he had any suggestions to make as to special treatment where there was shrinkage of estates involved.

Mr. Osgood made two suggestions; one, to have the Government extend the time for payment of the tax without charging interest, and the other, to exempt from Federal estate tax life insurance ear marked for the payment of taxes.

In line with Mr. Osgood's second suggestion the following pertinent facts in regard to estate shrinkage are submitted.

A survey of court records throughout the United States shows the following:

Number of estates	Approximate amount of each estate	Average cost of administration	Average cash in each estate	Average cash deficiency	Federal estate tax	State tax
		Percent	Percent	Percent	Percent	Percent
854-----	\$100,000	18.6	7.3	11.3	.9	2.7
412-----	250,000	21.2	4.7	16.5	4.8	3.1
273-----	500,000	24.7	4.2	20.5	7.8	3.6
148-----	1,000,000	27.7	4.4	23.3	11.2	4.2
31-----	5,000,000	42.8	2.0	40.8	26.9	5.5

	Name of decedent			
	Henry W. Farnam, New Haven, Conn.	Edith W. McLaughlin, Cleveland, Ohio	John I. Romer, New York City	Charles H. Scribner, New York City
Date of death-----	Sept. 5, 1933	Oct. 15, 1932	Aug. 9, 1933	July 3, 1932
Estate settled-----	Sept. 21, 1934	June 12, 1934		
Gross estate-----	\$736,996.74	\$1,061,917.00	\$1,662,114.00	\$1,871,326.00
Total costs-----	120,853.91	162,883.01	345,172.00	369,089.00
Net estate-----	616,142.83	899,033.99	1,316,942.00	1,502,237.00
Cash in estate-----	29,051.55	1,452.64	126,933.00	
Analysis of shrinkage:				
Debts-----	13,909.16	8,529.41	14,589.00	5,729.00
Administration expense-----	21,228.85	2,249.38	28,794.00	28,655.00
Attorney's fee-----	3,500.00	12,000.00	25,000.00	20,000.00
Executor's fee-----	7,500.00	19,271.00	60,000.00	50,000.00
State tax-----	21,772.52	34,269.22	65,439.00	82,179.00
Federal estate tax-----	52,943.38	86,564.00	151,350.00	182,526.00
Total costs-----	120,853.91	162,883.01	345,172.00	369,089.00
Additional Federal estate tax, if the decedent had died after May 10, 1934-----	28,500.00	53,200.00	99,100.00	121,400.00

All of these estates were settled prior to the Revenue Act of 1932 as amended by the Revenue Act of 1934, effective May 11, 1934, and the cost of administration does not in any case take into consideration the shrinkage in the value of the securities. Attention is called to the additional Federal estate tax on the four estates listed above had they been settled after May 11, 1934.

Estates of approximately \$250,000 settled under the 1934 law will pay approximately 33 percent more Federal estate tax than the same estates settled under the 1932 law. Estates of \$500,000 will pay approximately 50 percent more, and estates of \$1,000,000 will pay approximately 66 percent more.

Estates may shrink or appreciate in value after the death of the owner, due to the decreasing or increasing value of the property in the estate, but every estate will have some shrinkage at the time of death due to the cost of administration and taxes.

If the Government had seen fit to exempt the portion of life insurance used to pay Federal estate and State inheritance taxes, all of the afore-mentioned estates would have been in very much better condition, because it would not have been necessary to borrow against or sell any property in order to raise cash with which to meet the expenses of administration.

The only time when it is advantageous to sell property is on a rising market and no one has a guarantee that he is going to die when there is a rising market. On a sluggish or falling market only the very choicest property can be sold. This oftentimes means that the very heart of a man's estate is eaten into by a forced sale in order to provide money with which to pay the cost of administration.

There are many instances where a man's entire holdings are in a single business, of which he is the motivating factor. The forced sale or the procuring of a loan against the property in order to raise enough cash to settle his estate may mean turning the business over to those whose incompetence causes the business to fail. This would bring serious loss of income to those dependent on the original owner and throw out of work men who because of their age or specialized training may not find gainful employment again.

Placing a lien on the property until the tax is realized for the Government would make it difficult to transfer portions of the estate by sale, and would also make it cumbersome to administer the estate of a beneficiary whose death might occur before the lien had been lifted.

Then, too, the cost of collecting taxes over a period of years would be considerable, and if the estate should meet with severe reverses a lien against it would be worthless.

Since the executor is responsible for the payment of the tax, he would hardly dare take the chance of postponing the payment for fear the value of the estate would disappear and he would suffer a personal loss.

If a new tax measure is enacted increasing the rates, it will be even more imperative that some provision be made whereby cash can be realized immediately at death. There is no better means for doing this than through the medium of life insurance. Under the present law, however, when a man purchases life insurance to pay the death taxes, it becomes a part of his general estate and is taxed accordingly, as shown by the following example of an estate recently settled in Cincinnati. The decedent died May 2, 1934, and attention is called to the amount of tax paid, the amount which would have been due if the decedent had died after May 10, 1934, and the amount due if he had purchased life insurance to pay the taxes.

Taxes paid on estate as settled:

Gross estate.....	\$2, 928, 507. 92
Cost of administration.....	148, 317. 49

Net taxable estate.....	2, 780, 190. 43
Federal estate tax.....	335, 890. 85

Ohio tax.....	162, 656. 76
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Total tax paid.....	\$498, 547. 61
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Taxes due if settled under 1934 law:

Federal estate tax.....	569, 113. 70
Ohio tax.....	162, 656. 76

Total tax due.....	731, 770. 46
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Increase, 1934 tax over 1932 tax.....	233, 222. 85
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Taxes due if decedent had purchased life insurance to pay 1934 Federal tax:

Net estate.....	2, 780, 190. 43
Life insurance to pay Federal tax.....	569, 113. 70

Total.....	3, 349, 304. 13
Specific life insurance exemption.....	40, 000. 00

Net taxable estate.....	3, 309, 304. 13
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Federal estate tax.....	744, 428. 45
Ohio tax.....	210, 893. 20

Total tax due.....	955, 321. 65
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Increase over 1934 tax.....	223, 551. 19
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Taxes due if decedent had purchased life insurance
to pay 1934 Federal and State tax:

Net estate.....	\$2, 780, 190. 43
Life insurance to pay total tax.....	731, 770. 46
Total.....	3, 511, 960. 89
Specific life insurance exemption.....	40, 000. 00
Net taxable estate.....	3, 471, 960. 89
Federal estate tax.....	789, 876. 11
Ohio tax.....	226, 508. 25
Total tax due.....	\$1,016,384.36
Increase over 1934 tax.....	284,613.90

The increase of \$223,551.19 is 39.28 percent of the amount of insurance purchased to pay the 1934 Federal estate tax; and the increase of \$284,613.90 is 38.89 percent of the amount of insurance purchased to pay the 1934 Federal and State tax.

Men insure their lives so that in event of premature death the mortgage on the home will be paid off, children educated, business protected, income provided for families to take the place of earnings terminated by death. Isn't it just as good business to insure their lives to create cash to pay death taxes? Men do not have to buy homes, engage in business which needs protection, or have families. All these acts are voluntary and the desire to protect contingencies which arise at death is self imposed, whereas the tax is forced upon a man if he creates a sizable estate. Therefore insurance which is purchased for the purpose of furnishing money to pay death taxes should be exempt.

Along with insurance trusted to pay Federal estate and State inheritance taxes should be included the cash value of annuities, because in many instances due to age or infirmities insurance cannot be procured; and a great many men in recent years in order to augment their income have purchased annuities which also have cash values, and these cash values could be made available at death for the payment of taxes. In trusteeing insurance and annuities any amount over that required to pay the taxes should be included in the gross estate and taxed as provided in section 302 (g) of the 1926 Federal estate-tax law.

More and more the sons of men of large means are realizing that after all they are only trustees of the wealth which they inherit, and if they do not give a good accounting of their stewardship and become producers rather than pensioners, that which they inherit soon disappears. The beneficiaries of men who are considered fairly wealthy upon the death of the parent often find themselves in only moderate circumstances, because the estate has been divided among numerous beneficiaries.

A study of the directories of 25 or 50 years ago of all the cities in the United States of 25,000 population or over will show conclusively that wealth is continually being redistributed. These directories contain the names of prominent families who were once considered wealthy, who passed on to the next generation fair-sized estates which were dissipated by those who did not have the ability to manage their inheritances properly. Only in a very few instances do you find members of the same family managing the business started by the grandparent. In these instances the beneficiaries were qualified to act as custodians of the money which they inherited and managed the inheritance in a productive manner, thus continuing to create wealth and furnish employment for large groups of people who have no ability to manage. We must realize that the ability to manage is not given to everybody and care should be exercised not to destroy incentive and initiative which are essential in the building of estates to protect dependents and provide security in old age.

It is very obvious that you cannot create wealth by destroying wealth. Therefore in considering larger taxes means should be provided whereby these taxes can be paid at the least cost to the taxpayer.

Permitting the exemption of that portion of life insurance and annuities used to pay the Federal estate and State inheritance taxes would not guarantee that the estate will remain intact after it reaches the ultimate beneficiaries, but would guarantee to the Government an immediate revenue and to the estate a divorce-ment of any governmental supervision.

The provinces of Canada have for many years exempted life insurance for the purpose of paying death duties, and some provinces also exempt from income tax the amount of premiums paid on such life insurance.

The National Association of Life Underwriters has consistently urged all life insurance agents to cooperate with the Federal, State, and local governments in matters of taxation, has frowned upon any attempts to dodge legitimate taxes and has done all in its power to induce men to purchase insurance in order to produce cash at death with which to pay the cost of administering their estates.

We therefore urge that you give consideration to the constructive suggestion made by Mr. Osgood.

Respectfully submitted.

Law and Legislation Committee, National Association of Life Underwriters: C. Vivian Anderson, Cincinnati, Ohio, chairman; Chester B. Dobbs, Lincoln, Nebr.; George E. Hackman, Jefferson City, Mo.; Horace Mecklom, Portland, Oreg.; Julian S. Myrick, New York, N. Y.; S. R. Whitten, Jr., Jackson, Miss.; G. Cecil Woods, Nashville, Tenn.; Thos. P. Morgan, Jr., secretary to committee, Washington, D. C.

Senator KING. We will recess now until 10 o'clock tomorrow morning.

(Whereupon, at 5:15 p. m., the committee recessed until tomorrow, Thursday, August 8, 1935, at 10 a. m.)

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REVENUE ACT OF 1935

THURSDAY, AUGUST 8, 1935

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in the Finance Committee room, Senate Office Building, Senator Pat Harrison presiding.

Present: Senators Harrison (chairman), King, George, Walsh, Barkley, Gore, Bailey, Clark, Byrd, Guffey, Metcalf, and Capper.

The CHAIRMAN. The committee will be in order.

Mr. Ellenbogen?

(No response.)

The CHAIRMAN. Mr. Hill, American Association of Advertising Agencies?

Mr. GAMBLE. I am Mr. Gamble appearing for Mr. Hill, who had to leave.

The CHAIRMAN. Very well.

STATEMENT OF F. R. GAMBLE, EXECUTIVE SECRETARY AMERICAN ASSOCIATION OF ADVERTISING AGENCIES

The CHAIRMAN. How much time do you require, Mr. Gamble?

Mr. GAMBLE. Not over 10 minutes.

I am now and have been for the past 6 years executive secretary of the American Association of Advertising Agencies. I have been associated with this business for the past 12 years. Primarily, my remarks are made in the interest of the American Association of Advertising Agencies. These remarks are directed to the subject of the excess-profits section of the proposed Revenue Act. I do not propose to discuss the pros and cons of the excess-profits tax provisions, but only the bearing of the proposed provisions on personal service corporations such as advertising agencies.

In the case of the industry with which I am connected I should like to call the attention of this committee to the fact that the raising of taxes through the medium of excess-profits taxes is not a new vehicle. The revenue laws of 1917 and 1918, et cetera, imposed in addition to a normal tax, what were then known as excess-profits taxes. The basis upon which these taxes were assessed was the relation between the profits of a corporation and its invested capital. In other words, the greater the corporation's net profit on a given invested capital, the greater excess-profits taxes it paid. However, in the consideration of the past excess-profits tax laws, and in the hearings on this subject, the Congress took definite recognition of the fact that there

were certain types of corporations to which this excess-profits tax did not apply.

It called these corporations personal service corporations, and distinguished between them and ordinary corporations engaged in trade, manufacturing, and merchandising. On what grounds did it make this distinction? It defined a personal service corporation as a corporation "engaged in rendering personal service as distinguished from trading, merchandising, or manufacturing", the principal owners of which were regularly engaged in the active conduct of its affairs; further, that the income must be ascribed primarily to the activities of its principal owners, and still further, that its capital, whether invested or borrowed, must not be a material income factor. Now, because the basis of the excess-profits tax was the relation of income to the capital investment of the corporation, it was recognized that there were some businesses wherein the profits of that business had no relation to the amount of its invested capital, declared capital, or call it what you will. Companies of this character might conceivably be incorporated insurance underwriting agencies, real-estate concerns, incorporated groups of architects, or perhaps a corporation of public accountants, et cetera. In businesses such as these, capital, it must be apparent to your committee, has no relation to the profits. Essentially, in a business of this type, the profits result from some type of personal service, some type of ability or counsel of a professional nature. The type of business I am here to discuss is that of an advertising agency.

Briefly stated, the services rendered by it consist in counseling and advising clients in connection with advertising their services and products.

The capital that is invested in an advertising agency is merely of a nominal amount. Business and its resulting income is not obtained by the advertising agency because of the amount of capital it might have in its operations. Business is obtained by the advertising agency entirely on the basis of competent services and ability to render successful merchandising and advertising plans. Such capital as is invested, is invested primarily for the payment of current expenses, such as rent, office and clerical staff, and similar expenses. It has been said that a professor sitting on one end of a log and a student on the other, constitutes a university. If that is true, it is equally true that an advertising agency sitting on one end of a log, with a client on the other, constitutes a personal-service corporation.

The point that it is important to bear in mind is that an advertising agency might easily double its capital without enhancing its profits one iota. In this respect it is entirely unlike that type of business where capital can be invested in additional plants or other facilities for expansion purposes, that would in turn enhance the profits of that corporation.

An advertising agency does not use capital to buy and sell any commodity. An advertising agency receives its revenue and therefore its resulting profits from fees and commissions largely the same as an architect, a doctor, dentist, accountant, or some other type of professional man. Now, the present act provides for an excess-profits tax to be based on a ration of net income of a corporation to the "adjusted declared value" of its capital stock, as provided under section 701 of the Revenue Act of 1934. The graduated rates now proposed in lieu of the present uniform 5-percent rate are as follows:

	<i>Percent</i>
Net incomes not in excess of 8 percent of adjusted declared value.....	(1)
8 percent to 12 percent of declared value.....	5
12 percent to 16 percent of declared value.....	10
16 percent to 25 percent of declared value.....	15
25 percent of declared value.....	20

¹ No tax.

The term "adjusted declared value of its capital stock" as used here is analogous in principle to the invested capital in the Revenue Acts of 1917 and 1918. Here again, as in the 1917 and 1918 Revenue Acts we find the amount of excess-profits taxes to be paid, to be determined by the rate of net profit that a company earns on its capital structure. It becomes evident that if all of the net profits in excess of 8 percent allowed by the proposed tax bill were taxes as excess-profits taxes, in the case of a personal-service corporation, it would virtually amount to confiscation.

Take, for example, a moderate size corporation doing an annual volume of business, let us say of \$1,200,000, or an average of \$100,000 advertising per month for its clients. It earns, we will say, 3 percent on that volume, or a net of \$36,000. According to the average sound practice, this advertising agency would have a working capital of about \$50,000. In other words, its net earnings would be 72 percent of its working capital, and under the proposed act, 64 percent of these earnings would be subject to the excess-profits tax. This would be manifestly unfair. It would deprive the advertising agency business of an adequate net profit in order to carry on. Three percent of the total turnover is little enough even in a large agency, considering the hazards of the business. I have mentioned 3 percent net profit. Experience has shown that the average net profit is something less than 3 percent. Authoritative figures to substantiate this estimate can be given to the committee if it so desires.

It is my belief, based on my own experience and knowledge of the advertising agency business that in practically all instances the agency's entire net income would exceed 25 percent of the capital it has invested in its business.

Senator KING. How many advertising agencies are there in the United States?

Mr. GAMBLE. One thousand five hundred is the total number listed in all sources.

Senator KING. Are their fields confined generally to the States in which the organization has its headquarters?

Mr. GAMBLE. No; they place advertising throughout the country, and some have offices throughout the country. Some have as many as 8 or 10 different offices in different cities.

Senator KING. Have they any capital stock?

Mr. GAMBLE. Yes; most are incorporated.

Senator KING. And those that are not incorporated, I suppose, are partnerships or individuals?

Mr. GAMBLE. Right. Very few partnerships. There are quite a large number of individuals. Very small agencies are individuals.

Senator KING. Would the argument which you are making in behalf of the advertising men apply to other personal-service corporations?

MR. GAMBLE. I think it would, so far as I know. It would—those who met the same conditions which I have described in the early part of my statement.

Senator KING. Proceed.

MR. GAMBLE. It is my belief, based on my own experience and knowledge of the advertising-agency business, that in practically all instances the agency's entire net income would exceed 25 percent of the capital it has invested in its business. And thus, to be taxed in the highest bracket at the rate of 20 percent—add to this the normal tax which is now being contemplated at between $13\frac{1}{4}$ to $14\frac{1}{4}$ percent—it is immediately apparent to members of this committee that something like one-third of the entire net income of the advertising agency would be paid out in Federal income taxes; to say nothing of the other taxes, State income taxes, State franchise taxes, and so forth.

Previous revenue acts that apply an excess-profits tax have recognized this injustice and made provision for exemption of these personal service corporations which can show that there was no relation between capital and profit. The Revenue Act of 1918, in section 327, went quite far along this line when it stated—

That in the following cases the tax shall be determined as provided in section 328 (d), where, upon application by the corporation, the Commissioner finds and so declares that the tax if determined without the benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship, evidenced by the gross disproportion between the tax computed by reference to representative corporations specified in section 328.

The chief abnormality from which personal-service corporations require relief is the very fact that capital is not required in its business for profit and is not used in its business as the means of earning its profit. In this respect the rendering of its service as an advertising agency is essentially and entirely different from trading, or the use of capital as a merchandising or manufacturing corporation would use it in its operations.

Senator KING. Would the act of 1918 to which you referred meet the situation?

MR. GAMBLE. Yes; essentially it would.

Senator KING. Would the last revenue act imposing taxes?

MR. GAMBLE. Since 1918, I believe, there has been no special provision for personal-service corporations nor special hardship. It is when you get into excess-profits taxes that it bears especially hard on the personal-service corporation.

It might be pointed out in passing that there are very few corporations, as we ordinarily understand them, that would earn 25 percent on declared capital, assuming that declared capital would be the same as invested capital, and it is the personal-service corporation that would fall largely in this highest bracket, because of the nominal amount they have invested.

The problem is not answered in the case of personal-service corporations by the statement that they can declare their capital as provided under section 701 of the Revenue Act of 1934 and thereby state a capital which may be substantially greater than its actual invested capital and thus, in this way, escape the penalty of an abnormality between capital and profit.

Let us take, for example, the case of the advertising agency referred to above, and let us assume that instead of its actual capital of \$50,000,

it had stated its declared capital as \$200,000. In addition to its normal income tax, it would pay an excess-profits tax at the rate of 15 percent, because its net profit is 18 percent of its declared capital value. Let us assume further that because of the service it has rendered its clients additional business is attracted to it. It might very well over night acquire another account or two that would double its business, increasing it from \$1,200,000 to \$2,400,000. The normal experience of the industry would indicate a net profit on the total volume of \$72,000; \$72,000 is 36 percent of its declared capital, and it automatically gets it up again into the highest bracket, because there has been no adjustment of its capital structure.

I desire to urge upon your committee the vital importance of exempting personal-service corporations such as advertising agencies from the provisions in the tax bill now before you, which imposes an excess-profits tax on that type of corporation.

The CHAIRMAN. Thank you very much. The next witness is Mr. E. C. Alvord, representing the United States Chamber of Commerce.

Mr. ALVORD. Yes, sir.

The CHAIRMAN. How much time do you want?

Mr. ALVORD. I think about 15 minutes.

STATEMENT OF ELLSWORTH C. ALVORD, WASHINGTON, D. C., REPRESENTING THE UNITED STATES CHAMBER OF COMMERCE

Mr. ALVORD. Mr. Chairman and gentlemen of the committee, on yesterday, Mr. Claussen, the chairman of the committee on Federal finance, United States Chamber of Commerce, appeared and discussed before you the pending bill with respect to the corporation and individual income-tax rates.

Mr. Osgood, a member of the committee, appeared and discussed the proposed inheritance tax.

Professor Fairchild discussed the general economic and fiscal effects of the pending bill, and it is my privilege to discuss with you the proposed excess-profits tax.

Any excess-profits tax is necessarily capricious, unfair, discriminatory, and unsound. Human ingenuity has not yet devised an excess-profits tax which is otherwise. It discriminates against small corporations and in favor of big corporations. It discriminates against personal-service corporations and against other corporations. It discriminates against corporations by reason of the manner of their capital structure. It discriminates severely against income resulting from long-time efforts or processes. And it discriminates most harshly against income resulting, for example, from years of development work. Tax liabilities are governed not at all by income but by pure fortuitous circumstances, accidents happening that have nothing at all to do with tax liabilities. That is my characterization and the chamber's characterization of an excess-profits tax in general.

Let me now discuss if I may, the proposed excess-profits tax contained in the bill pending before you.

Fundamentally an excess-profits tax is designed to extract for the Government a portion of the profits in excess of a specified amount. Now, our job is to determine what is that specified amount.

During the war, we had an excess-profits tax. The amount of the excess profits was computed in a rather difficult way.

Briefly, it was based on what was considered the excess over a reasonable return upon invested capital. Generally those advocating an excess-profits tax admit that the excess profits should be computed either upon the amount invested in the business or the value of the capital assets which are productive of the income.

I am very confident that I need remind no member of this committee of the difficulties encountered with our war-time excess-profits tax. It is true that they yielded in 1918, I think, about two and a half billion. We generally figured that the war-profits and excess-profits taxes for 1917, 1918, 1919, 1920, and 1921 yielded roughly \$4,000,000,000, but they did it at a tremendous sacrifice to taxing principles, and they did it at terrific administrative difficulty and expense.

The excess-profits tax in the pending bill does not take into consideration any of the innumerable factors which should be considered in the proposition of an excess-profits tax, should the Congress decide to use that tax as a revenue-raising device.

In lieu of what normally would be expected as proper guidance, the House bill bases the excess-profits tax upon the so-called "adjusted declared value." To explain that, I would like to discuss rather recent history just briefly.

The old capital stock tax was repealed in 1926, and it was repealed primarily for two reasons. The first reason was that it involved a valuation of all of the corporate assets of the country, which was admittedly an impossible administrative tax; and the second reason, which was just as important, was that the capital stock tax imposed double, triplicate, and quadruple taxation upon corporations. That appears in your own committee report.

The CHAIRMAN. Did you write that report?

Mr. ALVORD. If I did, Mr. Chairman, it was as an employee of this committee.

The CHAIRMAN. And it was a good report.

Mr. ALVORD. Now, we come to the National Industrial Recovery Act. As I recall that act, there was appropriated some \$3,200,000,000 and that act was designed to raise, I think \$220,000,000, which was the sum estimated as sufficient to pay the interest upon the amount appropriated plus a reasonable sinking fund.

So that you were confronted with the necessity of raising \$220,000,000. The House, as is usual, had its ideas as to how that \$220,000,000 should be raised. It did so, generally, by increasing individual surtax rates and a slight increase I think in the corporation rates.

Then the bill came over here. This committee decided to continue and impose various excise taxes, and I can still see perhaps the leading members of this committee confronted with a problem. With the various devices which they had accepted down to that time, they still needed \$80,000,000, and it was suggested that the old capital stock tax be restored for the purpose of raising \$80,000,000.

The objections to the old capital-stock tax were well known, and they were considered, and probably the chairman of this committee may have said, "Is there not some way that we can get around those objections?" And this committee considered a way of getting around those objections and of raising \$80,000,000.

They did it in this way: They said, "We will avoid the necessity of valuing all of the corporate assets of the country by putting the burden upon the taxpayer. We will let him declare the value of the

corporate assets, and we will not review that value. That will be final. We will control that value so as to compel a reasonable capital-stock tax, but for no other reason, by the imposition of a 5-percent penalty so-called 'excess-profits tax,' but a 5-percent penalty upon an amount of income, upon all of the income of the corporation in excess of 12½ percent upon its declared value."

That gave you a very simple and effective device for raising temporarily \$80,000,000.

The CHAIRMAN. And there was little or no opposition to it.

Mr. ALVORD. There was little or no opposition to it and it has worked very smoothly and effectively. The cost of administration must be much less than one-tenth of 1 cent per thousand. There is no cost. It works smoothly and it raised the \$80,000,000.

Now, you will recall that the National Industrial Recovery Act was to be only of temporary effect—that is, the tax provisions. The taxes imposed by that act were to be repealed and discontinued on the happening of either of two events: First, the repeal of the eighteenth amendment; or, second, a balanced Budget.

Now, it happened that the eighteenth amendment was repealed first, so that under the theory of the National Industrial Recovery Act and the theory back of this precise capital-stock tax, it should have been in effect for nearly a year or slightly over a year—2 years at the most.

But then we were faced with a continuing deficit, so that the 1934 act came along to produce additional revenue. The 1934 act adopted as a permanent part of our revenue system, insofar as any provisions of the 1934 act can be considered permanent, the same capital-stock-tax and excess-profits-tax provision.

Congress, of course, gave to the taxpayer a new opportunity to declare his value. In my opinion, the taxpayer should have been given that opportunity every year, but the 1934 act did not do so. The 1934 act prescribed for the second and each subsequent year certain adjustments to the value declared for the first year.

Now, let me picture the precise situation. Under the reports of this committee, pronouncements of its chairman on the floor of the Senate, and the admitted theory back of the capital stock tax, a corporation did this, and it was intended that it should do this—a responsible official sat down and said: "Gentlemen, what will our income be this year?" "All right, we will take that amount. Maybe we will double it. In any event, we will increase it in order to be liberal and to play safe. We will use eight times that as our declared value. Eight times our own anticipated income will be our declared value. That makes us pay a reasonable, fair and proper capital-stock tax and exempts us if we guess correctly from the penalty"—and that is precisely, I think, what practically every corporation in this country did. It was precisely what you wanted them to do.

Now, we come to the second year and we take that guess which the corporation makes—a purely fictitious figure—an estimate which in no case is correct or accurate, and then we make certain adjustments to it. Generally speaking, those adjustments are designed to add to that declared value everything that has gone into the corporation during the year, and to subtract from that declared value everything that has gone out of the corporation during that year.

Those adjustments, even based upon that theory, are fictitious, unreal and incapable of determination. So that as a basis of the excess-profits tax as now proposed, we have this: We start with an unreal fictitious figure; we add to it and subtract from it a heterogeneous mass of unrelated items, unrelated to the original declared value, unrelated to themselves, and unrelated to the result which this committee was attempting to reach.

That, gentlemen, is the value which the pending bill proposes to use for measuring excess profits. There is, so far as we can see, no conceivable justification for basing an excess-profits tax upon any such unreal and fictitious arbitrary figure.

I agree entirely with what the Treasury representative said yesterday. An excess-profits tax will discriminate severely against the small corporation. The small corporation necessarily has greater fluctuations in income. One year they hit and they hit well, and then they go for 2 or 3 or 4 years at losses. Their income is subject to all of the uncertainties of human life, because normally they are controlled by one or two men. Some genius will have run the corporation for a while and he will hit, and then they will struggle on through. The excess-profits tax in the pending bill is going to make those fellows pay terrifically in the year in which they hit, and is not going to consider at all the years in which they fail.

Senator KING. Mr. Alvord, do you think with the experience which we had with the excess-profits tax during the war, that the theory which you are now explaining was demonstrated, namely, the small corporation was hit more severely than the large one?

Mr. ALVORD. Unquestionably, Senator; unquestionably. Not only hit, but hit badly.

Senator KING. The large corporations were hit severely too?

Mr. ALVORD. Yes, sir.

Senator KING. They were the ones that gave us those several billion dollars annually for taxes. My recollection was that the small corporations were not such large contributors in proportion to the capital invested.

Mr. ALVORD. Except in the years in which they happened to have extraordinary income. During the 4 or 5 years of the excess-profits tax, probably your small corporation had at least 1 and maybe 2 extraordinary years, and then we took substantially all of their income and left nothing for them to apply against their losses.

Senator KING. Still, the corporations are subject to fluctuations in their expenditures and in their income?

Mr. ALVORD. That is most certainly true, although as the Treasury representative said, large corporation income undoubtedly is more stable. When we say "stable" we mean merely that the fluctuations are not so great. Their extraordinary income is not multiplied and their losses are not so great, but they do have unfortunately—and they have had during the past several years—tremendous decreases in income and in the case of many corporations, substantial losses.

Senator KING. As a matter of fact, many of the large corporations during this depression have had no returns particularly, and have been continuing their operations by the use of their reserves.

Mr. ALVORD. That is certainly very true, sir, and you can see it in your own figures. Certainly there was some reason for the decrease in the revenues from a billion and a half on corporations to

approximately \$300,000,000. In my opinion, this tremendous decrease is decidedly contrary to the Treasury statement that a stable income would result from the proposed graduated tax on corporate income.

Senator BAILEY. Can the small corporations not protect themselves by increase in the salary of their officers?

Mr. ALVORD. That of course, sir, is one of the many difficulties which you will always find involved in an income tax. There is no such thing as a simple income tax—

Senator BAILEY (interposing). The big ones could not do that very well, but the little ones could.

Mr. ALVORD. Yes, sir.

The CHAIRMAN. What is the present capital-stock tax?

Mr. ALVORD. It is a dollar per thousand.

The CHAIRMAN. As an expert, may I ask you, would there be less objection to increasing the capital-stock tax from a thousand up in order to get about the same amount of revenue as is estimated we will get from the present capital-stock tax plus this excess-profits tax which is put on in this bill?

Mr. ALVORD. Senator, I will be very glad to answer after I tell you what that means. Your excess-profits tax proposes to raise \$100,000,000 from corporations. I should think that this committee would first pause and ask themselves: "Do we want to extract from corporate incomes at this time an additional \$100,000,000?"

The CHAIRMAN. I am putting the question to you as an expert. If we raise on a capital-stock tax under the present law something like \$80,000,000, and they seek to raise about \$20,000,000 more by virtue of adding this excess profits tax—

Mr. ALVORD. \$100,000,000 more. You will continue to have your \$80,000,000 which, as a matter of fact during the current year will be about \$95,000,000.

The CHAIRMAN. This would be impossible to get the additional \$100,000,000 by increasing the capital-stock tax?

Mr. ALVORD. You have got to double it. You will have to double your capital-stock tax.

Then I want to point out one more fact. Bear in mind that your capital-stock tax is paid—which in my opinion is one of the advantages of it—is paid by the corporations whether they have income or not, and I do not believe it very wise to attempt to collect \$2 a thousand on all of the corporations in the country, the small and the large, even at the present time, whether or not they have income. So long as you keep your rates low—

The CHAIRMAN (interposing). If I understand then, you believe this would be preferable?

Mr. ALVORD. Not at all. I would negative both.

Senator BARKLEY. If you had to accept one or the other, which would you take?

Mr. ALVORD. I think I would take the capital-stock tax provided you would give us a new declaration each year which, after all, is the fundamental principle of fairness in your present capital-stock tax, so that we would not be penalized if we cannot anticipate what our income is going to be 10 years from now.

Senator METCALF. If you have a capital-stock tax, they may be losing money in a concern, and then what do you do?

Mr. ALVORD. Senator, that is a general criticism which is urged against the capital-stock tax and which I attempted to point out. It is a tax imposed upon a corporation even though it receives no income. That difficulty, however, is overcome in part by the present theory of the capital-stock tax which merely say this: "Gentlemen, sit down and determine whether you are going to have income. If you estimate your income, guess it, multiply that by eight, and that will be the value upon which we impose the capital-stock tax."

So that if your corporation is certain that it is going to continue at a loss for several years, then it can pay but a very small capital-stock tax or perhaps none.

But I would suppose that no one in business is going to sit down and say "I will have a loss every year from now on", because otherwise he is going to quit business.

So that that is the result, and to me \$2 a thousand is a very extraordinary price to ask a corporation to pay purely for the privilege of being a corporation. It is my opinion that a capital-stock tax must be kept at a very low rate, if it is to be imposed at all.

The CHAIRMAN. What is the highest capital-stock tax we have put in?

Mr. ALVORD. \$1 a thousand.

The CHAIRMAN. We have never gone over it?

Mr. ALVORD. Not that I know of.

Senator BARKLEY. What do you mean by suggesting that the value, the declared value, be adjusted every year?

Mr. ALVORD. Just before you came in, Senator Barkley, I explained the principle of the present law.

Senator BARKLEY. I do not want you to repeat it. I am sorry that I was not here.

Mr. ALVORD. I can do it in just a minute.

In the National Industrial Recovery Act and again in the 1934 act you adopted the capital-stock tax upon the theory that you had overcome the objections to the prior capital-stock tax. Those objections were twofold. First, it required a valuation of all of the corporate assets in the country, which had proved quite impossible. Secondly, it proposed multiple taxation.

To avoid both of those things, you said, "We will let the corporation declare its own value for the capital-stock purposes. Then we will protect the Treasury by a penalty of 5 percent of the amount by which it errs. If it does not pay enough, then we will collect a so-called 'excess-profits tax' of 5 percent upon the amount of its income each year in excess of 12½ percent of its declared value." That was a very effective, smooth-working tax as a temporary measure. It will be far smoother working and effective with an annual declaration of value. But with adjustments for the second and each succeeding year, you lose simplicity, you run right square into multiple taxation. So that you will then have restored both of the objections to the old tax.

You have overcome the vital objections for the first year. You should also overcome them for each year. You should give a declaration of value for each year. The corporations will pay, and you will get your \$80,000,000. You are getting about \$95,000,000 now. You will get that, but do not stretch your tax so that you will attempt to collect an impossible amount from it.

A capital stock tax such as you have got in the present law with a new declared value each year will produce for you substantially \$100,000,000. Do not try to get more from it.

In this connection, I desire to point out that Mr. Jackson yesterday stated in his discussion of the excess-profits tax that after all there is nothing in the present law which would prevent a tax-free reorganization for those corporations who had guessed wrong on their declared value. I desire to make two observations on that statement, both of which I am sure he will agree to.

The first is that under the present law you are limited to a technical consolidation of your corporations. All the other various so-called "reorganizations" which under the present law are again so-called, "tax free", are not available. The Treasury has so ruled, and in my opinion it is sound, because it is only through a technical statutory consolidation that you get technically and legally, and it is pure legal fiction, but nevertheless it is there, technically and legally you get a new corporation. So that your new corporation then begins its first year all over again.

But mergers, acquisitions of stock, acquisitions of property, recapitalizations, all the various tax-free reorganizations of the present law are not available.

Then I would like to ask Mr. Jackson whether he will rule definitely and finally that a consolidation of corporations devised, intended, and carried out solely for the purpose of avoiding excessive excess-profits taxes will be tax free.

In other words, first, there is only the one device possibly available to us; second, I doubt seriously whether the Treasury will rule that that is available. With the result, that after years of litigation, perhaps some court of last resort in the decision of which the Treasury will acquiesce, will rule perhaps that our consolidation was tax free, and that it did give us an opportunity to declare new value, and in the meantime we are up in the air, an impossible situation.

I do not think it is fair even under the Treasury's statement, and even if they would say that consolidations are permissible to avoid extraordinary excess-profits taxes, I do not think it is fair to say to the corporations in your State, Senator, where they cannot consolidate that that method is not open to them, whereas they will say to Senator Metcalf's corporation "Yes; you may consolidate." It depends entirely upon the laws of the State whether there is such a thing as a consolidation. It is my impression that there are about 16 States which do not provide in their corporation code for one of these strict technical consolidations.

Now, the House bill is designed to ease the tax on small corporations. I have already discussed the excess-profits tax possibilities in the case of the small corporation, and I do not have to tell you gentlemen that it is the small corporation which make the mistake. The larger corporations have their own staff reasonably familiar with tax problems, who protect them reasonably well, soundly within the law, and intelligently. It is the small corporation, the fellow that has not got his staff or has not available to him someone reasonably familiar with your tax laws, which makes the mistake.

Suppose that your graduated tax in the present bill does save a small corporation \$50—probably that is the amount which it can save, or a reasonable estimate of the amount. That same corporation, gentle-

men, is very apt to pay, and I give you the cases in my prepared statement, is very apt to pay an excess-profits tax somewhere from \$700 up.

So that I do not think that the present bill as it stands before you can be considered a real boon to the small corporations.

I also attach to the statement an analysis of what we call the impact of the tax upon stockholders. I will not attempt to discuss it with you; it will be in my statement.

To prove that I am not alone in this idea, I would like to read, which is the only matter I will read, the opinions of two Secretaries of the Treasury. Both men are outstanding and I respect their opinions as I am sure every member of this committee does.

Senator Glass as Secretary of the Treasury in 1919 in his report to Congress said:

The Treasury's objections to the excess-profits tax even as a war expedient (in contradistinction to a war-profits tax) have been repeatedly voiced before the committees of the Congress. Still more objectionable is the operation of the excess-profits tax in peace times. It encourages wasteful expenditure, puts a premium on over-capitalization and a penalty on brains, energy, and enterprise, discourages new ventures, and confirms old ventures in their monopolies. In many instances it acts as a consumption tax, is added to the cost of production upon which profits are figured in determining prices, and has been, and will, so long as it is maintained upon the statute books, continue to be, a material factor in the increased cost of living.

Secretary of the Treasury Houston, in his annual report makes a somewhat similar statement, which I will not read.

If the language which I have used in characterizing the excess-profits tax seemed severe to you at the time I used it, I think you will now agree that it was much more mild than the words used by Senator Glass.

If I may, I would like to summarize very briefly the position of the chamber of commerce as it has been presented to you by the four members of its Committee on Federal Finance.

Mr. Clausen, I think, pointed out very clearly that the proposed graduated tax on corporations in unsound for four reasons:

First, it completely disregards the capital used to produce the income.

Secondly, it completely disregards the nature of that capital.

Third, it completely disregards the number of stockholders of the corporation; and

Fourth, it completely disregards the tax-paying ability of those stockholders.

Let me assume that there might be some justification for it. In my opinion, these four serious objections to it must overcome any of the proposed benefits or advantages or justifications.

Mr. Clausen also told you that the proposed increased surtaxes will very seriously discourage new business enterprise and the expansion of present business. After all, it is the new enterprise and the expansion of enterprise upon which we can rely to gain on unemployment and get ourselves back into a more normal economic business condition. He also told you that the proposed increased surtaxes will undoubtedly tend to drive substantial funds into tax-exempt securities. Gentlemen, I do not think there is much necessity of forcing yourselves into competition with tax-exempt securities even if you look at it purely from the revenue point of view. If you look at it from the general welfare point of view, then I am sure you will not.

Mr. Osgood told you that the proposed inheritance tax was, first, very unsound in principle and had been abandoned by many States in favor of an estate tax. He also criticized many of the so-called "administrative provisions" in the pending bill designed to assist in collecting the inheritance tax.

The only thing that I can add to Mr. Osgood's statement is that he mentioned not more than 5 percent of the difficulties. I would suggest not that you take my word for it, although I rather think you would, that you ask your own legislative counsel whether he can draft within a year—give him a year—that is the time we used to take to prepare for a revenue bill. Give Mr. Beeman a year, a year to find out whether he can draft an inheritance tax of the nature proposed by the present bill, and an inheritance tax imposed on top of two estate taxes.

As I read the provisions of the present bill I merely said "Why does anyone wonder why tax bills are complicated?"

Then, Professor Fairchild, I believe, very successfully contended before this committee yesterday that the entire bill should be postponed and that it should be postponed primarily for two reasons:

First, to give you a chance to have a budget in front of you. You know, in the old days, we used to prepare revenue bills by having a budget both of receipts and of expenditures, and if our expenditures were going to exceed our receipts, we made an estimate of the amount. Whether it was \$200,000,000 or \$1,000,000,000 or, as it was in the war days, some four or five billion. Then we started to write a revenue bill which would produce the necessary revenue.

So far as I can see, the estimated \$270,000,000 in the present bill are just chance. It might as well have been \$70,000,000 or \$2,700,000. It is not designed to do any one particular job.

The CHAIRMAN. Would the Chamber of Commerce favor our writing a tax bill that would now balance the budget?

Mr. ALVORD. The position of the Chamber on that, Senator, is very clear. The Chamber says: "Continue under your present tax laws until you get out of the depression." You cannot collect taxes on income when there is no income. Give us a chance to increase our income, and the present law will produce all the revenue you want.

Senator KING. That will take several years.

Mr. ALVORD. I hope not.

The CHAIRMAN. We all hope not.

Mr. ALVORD. It may, but I certainly hope not. But in any event, when we do get back where you have adequate incomes to tax—and I am very serious—your present law is exceedingly high. It will produce tremendous revenues.

Senator KING. If there is any prosperity.

Mr. ALVORD. If there is any return of prosperity; any return of normal business activity. Five billion dollars, gentlemen, is a minimum under your present law. But if you need more revenue, then have the Budget in front of you, and determine how much money you want and prepare a comprehensive plan to do it.

Senator BAILEY. Are you arguing that this proposed law will tend to reduce the revenue rather than to increase it?

Mr. ALVORD. Senator, my own honest opinion—I will be glad to take up each of the separate estimates with you. My own honest opinion is that this present bill will over a period of years produce substantially no increased revenues.

Senator BAILEY. What effect will it have upon the taxpayers?

Mr. ALVORD. Those persons who happen to be caught are going to pay exceptionally extraordinary amounts.

Senator BAILEY. With respect to business and with respect to recovery, do you think this will interfere with recovery?

Mr. ALVORD. Most certainly.

Senator BARKLEY. If it is not going to produce any more revenue, how is it going to interfere with recovery?

Mr. ALVORD. That will take two or three sentences to explain. You of course are going to collect more revenue from your increased corporation income taxes. That certainly is true. If business continues as it was last year, an increased rate this year will give you more money. I do not know whether the estimates were based upon a continuity of business or an increase in business, but let us assume there is a continuity. Certainly your increase in your corporation rate is going to give you more money, but where will you lose? You will lose in your personal taxes; you will lose in revenues which you would have gained by added prosperity and which is retarded by this sort of a bill; you will lose in all of your various other taxes which are producing at the present rates a fairly substantial amount, but the revenues from which, in my opinion, will decrease in a period of years very substantially if the present bill becomes law.

Senator BARKLEY. The present corporation tax is a flat rate of 13½ percent?

Mr. ALVORD. Yes, sir.

Senator BARKLEY. This bill spreads that over two points, 13½ to 15½. Do you know what proportion of the corporations would pay less under that than they do now at 13½?

Mr. ALVORD. The Treasury representative gave his estimates on that, which I accept as being accurate. The House committee report gives its estimates. Viewed as I stated a moment ago, solely from the point of view of the income tax, a substantial number of corporations—roughly 90 percent of our corporations had less than \$25,000 worth of income—and those will be the fellows affected. Using this number, 90 percent will pay less income tax if their income this year is no greater than it was last.

Senator BARKLEY. If it is greater, they would not mind paying a little more, would they?

Mr. ALVORD. I don't think so. That is the general view of every taxpayer. However, as I pointed out, that same corporation which may save \$50 on its income tax, will, unless it is in an extraordinarily lucky situation, pay several hundred dollars more excess-profits tax.

Senator BARKLEY. As between a graduated corporation tax ranging from 10½ up to 16 about, we will say, and elimination of the excess-profits tax from the retention of the rates in the House bill and the addition of an excess-profits tax, which would you think would be preferable?

Mr. ALVORD. Well, the House bill has the small graduated rate plus the excess-profits tax. I take it your question is whether I would accept that or a greater graduation in the corporation rate?

Senator BARKLEY. Yes.

Mr. ALVORD. You make me select two very bad evils.

Senator BARKLEY. They cannot both be exactly the same?

Mr. ALVORD. The result will be different. Your excess-profits tax is going to be more severe, more harsh, greater hardship. Your excess-profits-tax liability cannot be anticipated by anyone under the present bill. I cannot do it and I do not think anybody can—just because I cannot tell you, Senator, what your income is going to be next year even though you could give your income for the last 25 years.

Senator BARKLEY. If I would give you my income for the last 25 years you would not be much better off. [Laughter.]

The CHAIRMAN. Was there something else?

Senator KING. I wanted to ask one question. The suggestion has been made about intercompany dividends being subject to tax. What is your view in regard to that, Mr. Alvord?

Mr. ALVORD. The President's message, as I recall it, proposed two things: A graduated tax upon corporate incomes; then, secondly, in order to prevent avoidance of the graduated tax upon corporate incomes, a small tax upon intercorporate dividends with, I think, the qualification that obviously that dividend tax should not be payable where the dividend goes to a sound investment trust or something like that.

I have got to discourse just a little bit on what I think is generally admitted to be the purpose and policy of your corporation tax. Ideally, but from, unfortunately, purely a theoretical point of view, however ideally, we should have no corporation tax. We should tax each individual stockholder of the corporation upon the corporation's earnings, whether distributed or not; exactly as we do today tax a partnership.

However, there are two difficulties with that. Each of them combined or one of them alone is why we have today and have had since 1909 corporation taxes.

First, the constitution won't let us tax undistributed profits, and your normal ratio in business is roughly that we distribute 60 percent of our profits and pile back into the business 40 percent. So that 40 percent would be completely exempt by reason not of policy but by reason of our constitution.

And secondly, we have just a plain procedural difficulty of collecting from several million individuals several hundred millions of dollars which now come from just a relatively few numbers of corporations.

So that for those two reasons we have a corporation tax.

Senator KING. If you will pardon me, I do not quite agree with your statement that you could not tax the undistributed profits. I think you can tax them.

Mr. ALVORD. I won't enter into a discussion with you on that, Senator—

Senator KING. Proceed then.

Mr. ALVORD. I will merely say that we have tried to and have not succeeded.

If we bear in mind that what we are doing with our corporation tax is merely attempting to tax the group of stockholders who own the corporation, then you see what an intercorporate dividend tax does; it merely adds, adds, adds to the taxes upon precisely the same income.

I do not know of anyone who admits that an intercompany dividend tax is sound. The only reason I am confident, that it is suggested is as a safeguard to protect the revenues in the event that a graduated

corporation tax is adopted. I will add that in my opinion even as a safeguard it is not necessary.

Gentlemen, the hazards—the plain business financial hazards—of busting up a large corporation into a large number of subsidiaries far outweigh the gains which might be made by a saving in the graduated tax. So that even for that purpose I do not think it is necessary, and I think is the only possible justification for it.

Senator KING. It would be provocative of a lot of litigation anyway, would it not?

Mr. ALVORD. Most certainly.

Senator KING. Have you any suggestion to make on the Board of Tax Appeals? I am rather interested in that, because under the investigation which the President's committee made, we made that recommendation.

Mr. ALVORD. I quite appreciate that you, Senator, and several other Senators here were largely responsible for the creation of the Board of Tax Appeals.

Mr. Jackson gave you some figures yesterday or the day before yesterday. Those figures, gentlemen, I do not think were new to you. I gave you substantially the same figure back in 1927. If I recall correctly, I gave you some 200 or 225 or 250 printed pages of statistics and facts and analyses and recommendations.

Mr. Jackson states that today there are something over 12,000 cases pending before the Board of Tax Appeals, involving roughly \$500,000,000 in back taxes. Then he states, and I agree with him perfectly on this, that the Board of Tax Appeals cannot conceivably dispose of on the merits, more than 1,600 cases. My own estimate would be 1,200.

Senator KING. Per annum?

Mr. ALVORD. Per annum. Whereas there are being filed with the Board some 2,000, 3,000, or 4,000 new cases, piling up in addition to the 12,000 plus which are already there.

Then he also makes this statement, that the Treasury is winning in its cases before the Board of Tax Appeals—I am not sure that I understood him correctly—only 20 percent of its cases.

Mr. JACKSON. Over the whole history from 1926.

Mr. ALVORD. What is the present percentage?

Mr. JACKSON. The present percentage is about 40, I think.

Mr. ALVORD. I just happen to reach a different conclusion from Mr. Jackson based on those precise facts.

First, I think the Board of Tax Appeals is unquestionably serving a most useful function. It is an independent body, deciding cases impartially and according to the law. It gives to the taxpayer a fair opportunity to get his correct tax liability decided before he is called upon to pay. But, gentlemen, you cannot force more than 1,200 to 1,600 cases on the merits through the Board of Tax Appeals a year.

What is the answer? The answer to me was not to increase the membership of the Board of Tax Appeals or to set up another tribunal.

Senator KING. Simplify your tax laws?

Mr. ALVORD. My answer is twofold. Simplify the tax laws, certainly, if you can, but next, settle your cases before they get to the Board of Tax Appeals, and I am sure that many of the members of this committee will recall that you approved the recommendations to

that effect which are made. Those recommendations were in effect for several years.

I am very glad to know that Mr. Jackson finds himself confronted with precisely the same problem that I found that I was confronted with back in 1926 when I first went down to the Treasury.

Something has to be done. I am sure that Mr. Jackson is going to return to the administrative settlement of tax cases and not force taxpayers to litigate practically every case that could arise.

Senator KING. Pursue something like the British policy, where they do not have any litigation hardly. They settle the cases.

Mr. ALVORD. Settle the cases; yes, sir.

I would like to make one more suggestion, and that is that the Treasury particularly in its regulations adhere a little more closely to the statute as Congress writes it. I can give you illustration after illustration—I am giving you my own personal opinion and not the Chamber of Commerce—I can give you illustration after illustration where the Treasury regulations go far beyond the admitted and acknowledged intent of Congress.

I would like to give you just one illustration, because I think it might appeal to you.

After considerable difficulty—and it was not encountered just last year—the present provisions of the 1934 act with respect to revocable trusts were adopted. For purposes of illustration, I will be a little bit general and perhaps inaccurate, but I want to give you the general picture. Your present law says this: If at any time I, the grantor of a trust, have the power to revest in myself the income from that trust or any of the trust property, then I shall be taxable upon that income. All right. That was the 1934 act evolved to correct many difficulties which appeared in the past.

What do the Treasury regulations say? They state that it does not make any difference whether the grantor has the power to revest in himself or not, we will tax the income to the grantor if by any possible contingency the corpus of that trust might revest in him.

That means, gentlemen, that you might create an irrevocable trust for the benefit of all of your known beneficiaries that you want to designate, and have a general clause, frequent in trusts, that in the event of the failure of beneficiaries, the corpus reverts to the grantor. The Congress has said that you may. But the Treasury says you may not, without having the Bureau tax you. That regulation in my opinion is not valid, but it is going to take litigation to upset it. It ties the hands of the Bureau officials, and unfortunately that is not the only illustration.

The CHAIRMAN. Mr. Alvord, on this bill, have you about finished?

Mr. ALVORD. Yes, sir; I have finished. I would like to add my endorsement of the suggestions that an appropriate amendment be adopted to permit the dissolution of subsidiaries without tax. Such an amendment is essential. It will have a most beneficial result.

The CHAIRMAN. We thank you very much.

Mr. ALVORD. I should like to have this additional statement incorporated as a part of my statement to the committee.

(The statement is as follows:)

Mr. Chairman and members of the committee: My name is Ellsworth C. Alvord. I have been engaged in the practice of law in the District of Columbia since resigning from the Treasury Department about 5 years ago.

As some of you know, I have assisted in the preparation of various revenue laws since the war, in the capacities of Assistant Legislative Counsel, employed by the Congress, and of special assistant to the Secretary of the Treasury. My service in the Treasury embraced some experience in the administration of the revenue laws. It is a privilege to appear before you today as a member of the committee on Federal finance of the Chamber of Commerce of the United States.

THE PROPOSED EXCESS-PROFITS TAX

Section 102 of the bill now pending before your committee proposes to impose a so-called "excess-profits tax" upon corporations. The rates are graduated from 5 percent to 20 percent, based upon the ratio of the corporation's net income (for income tax purposes) to its "adjusted declared value"—the value upon which the present capital stock tax is imposed. If a corporation has a net income in excess of 8 percent of its "adjusted declared value", the proposed tax will be imposed. For example, if a corporation's net income exceeds 25 percent of its "adjusted declared value", the amount of the excess will be subjected to a 20-percent tax.

A war-profits and an excess-profits tax were levied during the war period. For a time they produced a substantial revenue. In 1918, at the height of the war, these taxes yielded about 2.5 billion dollars. However, their yield decreased rapidly after hostilities ceased. In 1921, total collections (current and back taxes) from this source amounted to only 335 million dollars, though it had been officially estimated in the middle of the fiscal year that 350 million dollars in back taxes, alone, from this source would be collected. The records show that official estimates of the yield of taxes of this character have been far in excess of the revenues actually realized.

An excess-profits tax on corporate earnings violates all principles of taxation normally excepted as sound. It is capricious, inequitable, and uncertain. It penalizes conservatively managed enterprises and discriminates against them and in favor of inflationistic corporate finance. Even the excess-profits tax of 1918, representing probably the best which could be devised, was admittedly unsound, unfair, and discriminatory. Tax liabilities were controlled largely by fortuitous circumstances having nothing to do with income or ability to pay.

In theory, an excess-profits tax is designed to collect for the Government a portion of a corporation's profits in excess of a specified amount. Any attempt accurately to measure this excess amount requires a careful consideration of innumerable factors—none of which appears in the pending bill. "Excess profits" are usually considered to be true profits, computed realistically, in excess of a reasonable return upon invested capital of the corporation or upon the value of the corporate assets used in the production of its income. We have had considerable experience in the determination of "invested capital" and in the determination of the value of capital assets. The necessary appraisals of physical and intangible properties (including patents, copyrights, and goodwill) included in the assets of over 500,000 corporations is an admitted impossibility. Our experience furnishes sufficient proof with difficulties of this nature. The Bureau of Internal Revenue was clogged for years with these tax disputes, despite the fact that a very large number of the cases were settled without litigation. In 1934, 13 years after the repeal of the tax, for example, there were nearly 700 cases involving these questions still pending and unsettled.

BASIS OF THE PROPOSED TAX

Doubtless, it was the recognition of these facts which impelled the House of Representatives to attempt another basis for computing "excess profits" under the pending bill. The proposed basis requires a discussion and analysis of the term "adjusted declared value."

The old Federal capital-stock tax was repealed in 1926 primarily for two reasons: The annual determination of values involved costly difficulties for both the Treasury and the taxpayer; and the same assets were subjected to multiple taxation. (See Finance Committee Report on Revenue Bill of 1926, p. 11.)

Additional temporary taxes were imposed, as an emergency measure, by the National Industrial Recovery Act, to remain in force until the repeal of the eighteenth amendment or until we attained a balanced Budget. Among the means of raising additional revenues adopted by that act were the capital-stock and excess-profits tax provisions. These provisions were planned and enacted to produce an annual (though temporary) income to the Treasury of 80 million

dollars. The underlying theory of the provisions, as stated then by the Finance Committee, may be summarized briefly as follows:

1. A capital-stock tax is the best available method of raising 80 to 100 million dollars—if we can overcome the objections to the old capital-stock tax.

2. These objections can be overcome by permitting the taxpayer to determine and declare the value upon which the capital-stock tax will be imposed—and thus simplicity and low cost will be gained for both the Treasury and the taxpayers and multiple taxation will be avoided.

3. Adequate protection against unreasonable low declarations of value is afforded by the threat of an "excess-profits tax"—a tax of 5 percent upon the corporation's taxable net income in excess of 12½ percent of its declared value. This tax was not intended to be a direct revenue producer. It was merely a simple device to assure the payment of a reasonable capital-stock tax.

These taxes were in force for practically a year, when the Revenue Act of 1934 continued them as a permanent part of our revenue-producing system. Under the 1934 act, the capital stock tax for the first year was imposed upon the value declared by the taxpayer—a value which cannot be changed by either the taxpayer or the Commissioner. From the taxpayer's point of view, the determination of his value was a comparatively simple undertaking. He estimated his income for the year involved, increased his estimate somewhat to "play safe", and a simple multiplication gave him the value to be declared. For the second and each subsequent year the statute prescribes certain adjustments. Certain items are added to, and other items subtracted from, the value declared by the corporation for the first year. It is this "adjusted declared value" which is the basis proposed in the pending bill for the imposition of the new so-called "excess-profits tax."

ADJUSTMENTS TO DECLARED VALUE

Those familiar with the adjustments prescribed by the present law readily admit that they are inadequate and arbitrary, even for capital-stock-tax purposes. We begin with a declared value based upon a liberal estimate of prospective earnings—a necessarily fictitious figure—to which we add—

- (a) Cash paid in for capital stock—an actual figure;
- (b) The value of property paid in for stock—a figure based on an appraisal;
- (c) The corporation's taxable net income—a statutory and admitted arbitrary figure;
- (d) Nontaxable income—a semiactual and semistatutory figure; and
- (e) The "dividend deduction allowable for income tax purposes"—another purely arbitrary figure.

From the sum of the above we deduct

- (a) the value of property distributed in liquidation—a figure based upon an appraisal;
- (b) Distributions of earnings of profits—an actual figure, if determined according to sound accounting practice, but an arbitrary figure if computed in the manner prescribed for the determination of taxable net income; and
- (c) "the excess of the deductions allowable for income-tax purposes over its gross income"—a purely statutory and arbitrary amount.

We have then a group of heterogeneous and illogical adjustments have no real relationship to the original value, to each other, to the problem, or to the desired result. The following simple but striking examples illustrate the incongruous results of the adjustment formula contained in the present law:

1. *Appreciation of assets.*—Corporation A owns a property which cost \$50,000 and is now worth \$100,000. \$100,000 of A's declared value represents the property. The property is sold for \$100,000. The \$50,000 excess of selling price over cost is reflected in net income and must be added to the original declared value. The "adjusted declared value", representing the same \$100,000 of actual value, is now \$150,000. In addition, the \$50,000 profit is subject to income and excess-profits taxes, and after they are paid the corporation will have only about \$85,000 in value to represent its "adjusted declared value" of \$150,000.

2. *Depreciation of assets.*—Corporation B owns a property which cost \$100,000 and is now worth \$50,000. \$50,000 of B's declared value represents the property. The property is sold for \$50,000. The \$50,000 loss (if deductible for income tax purposes) must be deducted from the original declared value. The "adjusted declared value", representing the same \$50,000 of actual value is now zero.

3. *Different treatment of same loss.*—Corporations C and D are comparable in all respects and have the same declared value. Each owns a property X, which is worth \$100,000 in excess of cost and each owns a property Y, which is worth

\$100,000 less than cost. During a given year, C sells property Y, which has depreciated in value, and D sells both properties. Neither engages in any other capital transactions. Since C's loss is not deductible and D's is offset by its gain, both declared values remain unchanged. In the following year, C sells property X, which has appreciated in value. C's gain is not offset by any loss and, therefore, C's "adjusted declared value" exceeds D's by \$100,000, although the two corporations remain exactly comparable in all other respects.

4. *Transactions between corporations.*—Corporation E owns a property which cost \$100,000 and has increased in value to \$250,000. E declares a value of \$250,000. E then transfers the property to Corporation F (which had previously declared a zero value) for \$250,000 in F's stock. F then sells the property for \$250,000. Thus, the two corporations combined have nothing left but \$250,000 in cash.

If E's gain on transfer of the property to F is "recognized" for income-tax purposes, the adjustments will be:

E's declared value.....	\$250, 000
E's adjustment.....	150, 000
E's adjusted value.....	400, 000
F's adjustment.....	250, 000
Total adjusted value for \$250,000 in assets.....	650, 000

If E's gain is not "recognized", F takes E's cost "basis" for the property, and the adjusted values will be:

F's adjustment (acquisition).....	\$250, 000
F's adjustment (sale).....	150, 000
F's adjusted value.....	400, 000
E's declared value.....	250, 000
Total adjusted value for \$250,000 in assets.....	650, 000

The excess-profits tax proposed in the pending bill violates every fundamental canon of taxation. Liability for the tax can be neither certain nor definite. The tax is based upon a purely arbitrary and fictitious figure having no conceivable relation to the reasonableness of the income or the capacity to pay. Liability for the tax is not determined by real values or existing facts. Luck in guessing future income is the governing factor. Taxation of this nature is merely a lottery.

The capital-stock tax imposed by the 1934 act is exceedingly objectionable and should be amended to permit an annual declaration of value. But an attempt to use it as a basis for an excess-profits tax at the sharply graduated rates proposed in the bill is wholly without justification. Unequal burdens, unfair discriminations, illogical and unforeseeable liabilities, continuing uncertainties, and prolonged controversies must be the consequence to the taxpayers. Undeserved revenues and an exceedingly difficult, if not impossible, administration must be the consequences to the Treasury.

INEQUITABLE RESULTS

A few of the innumerable inequities of the excess-profits tax as now proposed can further be illustrated by concrete examples.

Assume three corporations with the same amount of capital, with plants built at the same time and having the same volume of business, reporting identical incomes representing only reasonable profits—after taxes are deducted—on the capital invested.

Company A was financed in part through the sale of \$300,000 of bonds. It originally sold \$200,000 of preferred stock. By paying only moderate dividends it has been possible to retire the preferred stock out of earnings, leaving only common shares and bonds outstanding. A conservative depreciation policy has been followed; \$500,000 appeared to the management to be a fair valuation of the corporation's capital assets, and this amount was declared as the value of capital stock for tax purposes. This company will be required to pay a capital-stock tax of \$500 and an excess-profits tax of \$14,750.

Company B was financed entirely through the sale of common and preferred shares, all of which remain outstanding. As in the case of Company A, a conservative depreciation policy has been followed. It has, however, paid out the

bulk of its earnings to retire its preferred-stock issues. A fair and reasonable value of the stock appeared to be \$1,000,000, and this amount was reported as the value of its capital stock for tax purposes. This corporation will be required to pay a capital-stock tax of \$1,000 and an excess-profits tax of \$5,000.

Company C was bought out prior to 1933 by a holding corporation which paid a substantial sum for the going-concern value, reflected in a large item for goodwill which had been capitalized. The company declared the value of its capital stock for tax purposes at \$1,500,000. It will consequently be required to pay a capital-stock tax of \$1,500 and an excess-profits tax of \$1,500.

To summarize, the combined amount of the capital-stock and excess-profits taxes on the above corporations would be as follows:

	Company A	Company B	Company C
Capital-stock tax.....	\$500	\$1,000	\$1,500
Excess-profits tax.....	14,750	5,000	1,500
Combined.....	15,250	6,000	3,000

The variation in the tax burden of these three companies, similar in all respects except as to form of capital structure, is striking, Company A, which has followed a careful, cautious financial policy, would be compelled to pay more than five times as much taxes as Company C, which pursued a different policy in building up its capital structure. Company B, which has followed a middle-of-the-road policy, would be taxed at still another rate, paying twice as much as Company C and less than half the amount imposed on Company A. A tax so unequal and so capricious and so penalizing to careful, cautious financial policies certainly cannot appeal to the committee.

EFFECT ON SMALL CORPORATIONS

It has been officially stated that 90 percent of the number of corporations would have their taxes somewhat reduced through the operation of the graduated principle applying to corporate income taxes, reducing the rate on corporations having less than \$30,000 income by one-half of 1 percent or less. Such a statement does not take into account other provisions of the bill, particularly the excess-profits tax. Let us assume a corporation with a capital of \$100,000 and profits, before Federal taxes of \$20,000—not an unreasonable amount. Under the bill the income tax would be reduced \$50. Assuming that it has declared capital stock value of \$100,000, the excess-profits tax would be increased by \$775, a net increase in taxes of \$725.

Assume another corporation with capital stock of \$150,000 and profits, before Federal taxes, of \$15,000—again a reasonable amount. Under the bill this corporation would pay \$75 less income tax; but assuming that its declared capital-stock value is \$150,000, it would pay an additional amount of \$120 in excess-profits tax, making a net increase of \$75.

The bill, if enacted into law, will be no boon to small corporations with a reasonable ratio of profits to declared value.

IMPACT OF CORPORATE TAXES ON STOCKHOLDERS

The impact of the proposed taxes on stockholders is a matter of real importance. Briefly, a study of this discloses, among other things, (1) discrimination against incomes, particularly small incomes, dependent upon dividends as compared with other income subject to the normal tax and surtax; and (2) a heavy increase in the impact of the tax upon corporate earnings that, under existing policy, would be available for dividends to stockholders, especially a heavy increase in the impact if such dividends were receivable by small stockholders. Since, however, a demonstration of these findings is somewhat involved for verbal presentation, it is not presented at this point but is discussed in the attached appendix.

OPINIONS OF SECRETARIES OF THE TREASURY

The taxpayer may be accused of being partial and having a selfish interest when taxes are discussed. Statements of former Secretaries of the Treasury are not open to such questions.

Your distinguished colleague, Senator Glass, when Secretary of the Treasury, in his annual report for 1919, in discussing the excess-profits tax, stated:

"The Treasury's objections to the excess-profits tax even as a war expedient [in contradistinction to a war-profits tax] have been repeatedly voiced before the committees of the Congress. Still more objectionable is the operation of the excess-profits tax in peace times. It encourages wasteful expenditure, puts a premium on overcapitalization and a penalty on brains, energy, and enterprise, discourages new ventures, and confirms old ventures in their monopolies. In many instances it acts as a consumption tax, is added to the cost of production upon which profits are figured in determining prices, and has been, and will, so long as it is maintained upon the statute books, continue to be, a material factor in the increased cost of living."

Secretary of the Treasury Houston, in his annual report for 1920, stated:

"The reasons for the repeal of the excess-profits tax should be convincing even to those who on the grounds of theory or general political philosophy are in favor of taxes of this nature. The tax does not attain in practice the theoretical end at which it aims. It discriminates against conservatively financed corporations and in favor of those whose capitalization is exaggerated; indeed, many overcapitalized corporations escape with unduly small contributions. It is exceedingly complex in its application and difficult of administration, despite the fact that it is limited to one class of business concerns—corporations."

APPENDIX

IMPACT OF CORPORATE TAXES ON STOCKHOLDERS

In determining the impact on stockholders, the total of all taxes imposed on corporations must be considered. Even so, in the following computations the Federal excise taxes which are mostly paid, in the first instance, by corporations, are not included and, insofar as they are not passed on to the consumers, must be absorbed by the corporations. Neither is there any account taken of the State corporate income taxes, franchise taxes, general property taxes, and the numerous other taxes imposed by the States and local communities on corporations. It is of interest to note in this connection that in 1933 New York State alone, exclusive of taxes levied by local communities in that State, collected from corporations \$1,022,531,379.

Concrete illustrations follow:

A manufacturing concern, company X, by reason of the development of a new product upon which research has been carried on at heavy expense for several years, reports enhanced net profits equal before Federal taxes to 35 percent of the declared value of its stock. A competing concern, company Y, which has undertaken no such expenditures and consequently has smaller earnings, reports a net profit before Federal taxes of 10 percent of the adjusted declared value of its stock.

The taxes paid by the two corporations under the bill would be as follows:

	Company X (adjusted declared value, \$1,000,000; net before taxes, \$350,000)	Company Y (adjusted declared value, \$1,000,000; net before taxes, \$100,000)
Corporate income tax.....	\$49,725	\$14,100
Capital stock tax.....	1,000	1,000
Excess-profits tax.....	39,500	1,000
Total.....	90,225	16,100
Percent of net profits.....	25.7	16.1

Assuming that all net earnings after taxes were distributed as dividends, a stockholder in Company X would in effect have suffered a tax, collected at the source, of 25.7 percent on his share of the corporation's net earnings. On the other hand, a stockholder in Company Y would have suffered a tax of 16.1 percent.

To ascertain the total impact on stockholders it is necessary to add to the effective rate applying to the particular corporation the surtax rate applying to the individual stockholder.

The two outstanding characteristics of the proposed taxes are, first, a heavy increase in the total taxes on small incomes dependent upon corporate earnings and, second, a discrimination against income dependent upon corporate earnings as compared with other income subject solely to the normal and surtaxes. This discrimination is most marked in cases of small incomes. Considering the two corporations above, an individual having a taxable income of \$6,000 from Corporation X would be subject to a total tax of nearly 27 percent. If he had a similar amount of income from Company Y, the tax would be about 17 percent. On the other hand, if his income were derived from sources subject to the normal and surtaxes, the effective rate would be but slightly over 5 percent. If an individual had a taxable income of \$10,000 derived from Corporation X, the tax would be approximately 28 percent, if accruing from Company Y, the tax would equal about 18 percent, while if derived from other sources the effective normal and surtax rate would be but 7 percent. Similar comparisons can also be made in other of the lower surtax brackets. This is elaborated in the accompanying table.

These taxes as now proposed would be utterly inconsistent with the officially announced purpose of the bill, which is to increase taxes on the larger incomes.

(The table is as follows:)

Effect of proposed taxes on individual stockholders

Income derived solely from dividends				Income subject only to normal tax and surtaxes—Effective normal and surtax rate
Surtax income bracket	Effective surtax rate	Total Federal corporate taxes and surtax upon stockholders in—		
		Company X	Company Y	
	Percent	Percent	Percent	Percent
\$6,000.....	1.3	26.9	17.1	5.3
\$10,000.....	3.0	28.2	18.4	7.0
\$20,000.....	6.3	30.6	21.2	10.3
\$50,000.....	15.4	37.3	28.9	19.4
\$100,000.....	30.0	48.2	41.2	34.0
\$150,000.....	39.3	55.0	49.6	43.3
\$200,000.....	44.5	58.1	53.8	48.5
\$500,000.....	57.2	68.3	64.0	61.2
\$1,000,000.....	64.1	73.4	69.8	68.1
\$5,000,000.....	71.8	79.1	76.1	75.8

Mr. ALVORD. I also would like to present a memorandum—I do not want to be heard on it—upon a proposed amendment to section 351 of the Revenue Act of 1934. The amendment is intended to correct an admitted inadvertence, as a result of which that section imposes an unintended penalty upon personal finance companies.

(The memorandum referred to is as follows:)

MEMORANDUM RE PROPOSED AMENDMENT TO SECTION 351 OF REVENUE ACT OF 1934, SUBMITTED BY ELLSWORTH C. ALVORD ON BEHALF OF THE AMERICAN ASSOCIATION OF PERSONAL FINANCE COMPANIES

OUTLINE OF ARGUMENT

INTRODUCTION AND STATEMENT OF CONTENTION

I. Description of personal finance business

1. Existence of business is caused by nature of modern society.
2. History of early development of business.
3. Description of uniform small loan laws.
4. Regulation of business by States drives out illegal "loan sharks."
5. Function of business is for provident borrowing.
6. Business is not unusually profitable.
7. "Interest" received by business is not "interest" as defined by section 351.

II. Purpose and real intent of section 351

1. Prevention of surtax avoidance by those who store up investments under corporate ownership and permit the income to accumulate.
2. Essential feature of personal holding companies is that their income comes from investments rather than from the operation of a business.

III. Distinction between "holding" companies and "operating" companies

1. Personal finance companies are "operating" companies.
2. Purpose of section 351 is to apply only to incorporated pocketbooks, yet in fact it extends to personal finance companies.
3. This misdefinition occurs through peculiarities of the word "interest."
4. Income of personal finance companies is not "interest" in the sense used by section 351.
5. Continued application of section 351 will ruin personal finance companies.
6. Many personal finance companies are also caught by 5-family rule of section 351.

IV. Remedy for this misdefinition is lacking under the revenue act

1. Technical provisions of section 351 require personal finance companies to pay out, not 80 percent but 90 percent or more of their commercial net income.
2. Provision to deduct amounts used to retire debts is unimportant, as most personal finance companies do not have funded debt.
3. Necessity for personal finance companies building up large reserves is great.

V. Suggested remedy

1. Insert after the word "interest" in section 351 the words "except lawful interest received from an individual on an indebtedness not exceeding \$300."
2. This remedy would not permit tax avoidance by an actual holding company.
3. Congress has already recognized the principle set forth in this remedy.

INTRODUCTION

Section 351 of the Revenue Act of 1934 was enacted to prevent tax avoidance through a personal holding company, the so-called "incorporated pocketbook." Personal finance companies are operating companies engaged in the business of making loans to individuals in amounts up to \$300. Their business is much in the nature of a banking business and is regulated in most States by the uniform small loan law. Section 351 specifically exempts banks from its application. However, by reason of the fact that substantially all the entire gross income of personal finance companies is probably in the nature of "interest", as that term is used in section 351, the section unintentionally and through error applies to them. It compels the impossible and inadvisable distribution of earnings or imposes an extreme and unavoidable penalty upon the proper and necessary accumulation of an adequate surplus.

The continued application of the provisions of section 351 to personal finance companies will work a serious hardship and ultimately will thwart and destroy an industry of great social and economic importance to the country at large. The increase in taxes proposed by the pending bill greatly accentuates the unintended hardship. We submit that the error should be corrected by an appropriate amendment in the pending bill.

In presenting the question we will (I) describe the nature of the personal finance business, (II) analyze the purpose and true intent of section 351, (III) distinguish companies engaged in this business from those which the section intended to penalize, (IV) indicate that there is no remedy for this situation in the law as it now stands, and (V) suggest a simple, safe, and logical method of amending the section so as to confine its effect to its real purpose.

I. Description of personal finance business

The personal finance business is engaged in lending money in sums up to \$300. Its loans are made to families needing financial aid in periods of emergency but lacking the security usually necessary to obtain bank credit. These loans are based on the signatures of husband and wife, one of whom must be gainfully employed, and usually secured by lien on the household goods. Some loans are made to unmarried persons of good standing. This business is regulated by State

laws. It is well known that statutes fixing rates of interest on money and defining usury are within the police power of the States; therefore, companies engaged in the personal finance business obtain their license to operate from the State. They are regulated by State law and supervised by State officials.

The lending of small sums of money to families is as old as recorded history, but it has only been within the last 20 years that the public in general and the legislatures of over half the States, including almost all the great industrial States, have come to recognize the economic and social significance of this form of credit, the necessity for its existence and the desirability of stringent regulation of its operations. Many volumes have been written regarding the long development of the business and the changes in governmental attitude toward it. Suffice it to say, the lending of small sums to necessitous people was for centuries considered a problem growing out of poverty and hence a subject for charity. It has become an economic necessity only within the last 50 years, due to the rapid growth of urban population and the mechanization of industry.

The moving of people from rural communities to large cities and the growth of mass production has caused an increasing dependence upon the pay envelope and has deprived the public of any legitimate means to tide over emergencies except temporary borrowing. It was soon observed that borrowers of small amounts were economically weak and that their necessity deprived them of equality of bargaining power with the lender. Necessitous borrowers were subjected to most oppressive treatment and unconscionable exactions of charges; rates of charge ranging from 10 to 25 percent per month were constantly collected from such persons by unregulated bootleg lenders, commonly known as "loan sharks." Thus the development of a source of cash credit for these people became a social and economic necessity.

The small-loan problem attracted a great deal of attention during the first decade of this century. There were legislative experiments in New York, Massachusetts, New Jersey, and Ohio, directed toward liberalizing the usury laws so as to permit operation of lending companies. Credit unions which had become common in the older countries of Europe, were tried and found to be effective in a limited way. Under the aegis of the Russell Sage Foundation legislation was also passed which permitted the operation of semiphilanthropic lending companies, limited as to their profits and authorized to charge rates of interest running up to 2 percent a month. These agencies rendered a good service but could not scratch the surface of the real problem because there was not sufficient philanthropic capital available. The Russell Sage Foundation is a well-recognized research organization in the social service field. While its headquarters are located in New York City, it is national in scope. It has no financial interest in any small-loan company and never has had. It has molded and guided the course of small-loan legislation and the development of the business as one of its many activities directed toward the improvement of living conditions in this country.

After considerable experience with charitable and semicharitable organizations, the Russell Sage Foundation in 1915 concluded that the remedy lay in a frank recognition of the fact that small loans to consumers had become an absolute necessity under modern economic and social conditions; and, further, that the long-run legislative objective should be to provide such credit through commercial agencies at the lowest possible charge to the borrower and under the most wholesome and complete governmental control. This decision led to the drafting of the first uniform small-loan law in 1915. Since then this law has been enacted in constantly improved form by 27 States.

THE UNIFORM SMALL-LOAN LAW

Under this law lenders must be licensed by the State, must give bond, and they are subject to constant and stringent regulation and control by a State official, usually the banking commissioner. The laws provide that charges may not be taken in advance nor discounted nor compounded but must be computed strictly on unpaid principal balances of cash actually received by the borrower for the number of days held by him. No additional fees, charges, commissions, nor any other amount whatsoever may be received by the licensee except a flat percentage amount so computed.

The borrower must receive a detailed statement of the terms of the loan and detailed receipts for all payments made; he may prepay the loan or any part hereof at any time, with interest only for the actual period during which the money is held by him. Confessions of judgment and powers of attorney are for-

bidden. No papers may be taken with blanks left to be filled after execution. All agreements must be in writing signed by the borrower and, in the case of chattel mortgages or wage assignments, by the borrower's spouse, if any. There are various other provisions to protect the borrower from any charges in excess of those permitted by the law and safeguards are provided to prevent harsh or oppressive practices.

Loans are limited to \$300 or less in principal amount to any one individual. The aggregate maximum rates of charge permitted, including reimbursement for all disbursements and expenses, vary from $2\frac{1}{2}$ percent, to $3\frac{1}{2}$ percent per month in the several States, computed on unpaid balances as stated above.

The uniform small-loan law is generally conceded by informed persons to be one of the most salutary, effective, and far-reaching remedial laws on the statute books in this country. It has created and controlled an adequate source of consumer credit for citizens whose circumstances deny them the use of the cheaper channels of credit, such as banks. It is reliably estimated that 80 percent of the families in this country do not have access to bank credit. These laws effectively prevented the extortionate charges and oppressive practices of illegal lenders whose operations in unregulated States constitute a social evil of the first magnitude.

The law has been advocated by the leading civic and social service organizations of the several States and the Nation. This law has been indorsed and signed by such outstanding Governors as Franklin D. Roosevelt of New York, Frank Lowden of Illinois, James Cox of Ohio, and Woodrow Wilson of New Jersey. The personal finance business has the endorsement of the banking commissioners or other public officials who supervise the business in these 27 States. Under their supervision there are today over 3,500 licensed and bonded lending offices serving 77 percent of the country's urban population.

Year by year new States enact the uniform small loan law and other States in which the law is already in effect bring it up to date by amendments which keep it effective and in tune with the changing circumstances of the times. These laws have been held constitutional by the supreme courts of numerous States. The United States Supreme Court has twice refused certiorari on constitutional questions.

The development of these small-loan agencies is an important chapter in the economic and social life of this country. In the past (and at the present time in the States where the uniform small-loan law is not now in effect) borrowers were subject to rates of charge ranging from 10 to 25 percent per month. These high rates and other evils of unregulated money lending have abundantly justified the interposition of the States' regulatory powers in enacting these laws. These high-rate money lenders, so-called "loan sharks", have constantly financed attacks upon the uniform small-loan law and those lenders operating under its provisions. In recent litigation the sworn testimony of the agents of notorious loan sharks and written records subpoenaed into open court have demonstrated that such attacks are financed by loan sharks alone for the purpose of preventing enactment of the uniform small-loan law which drives them out of business wherever it goes into effect. Any infraction of the provisions of the uniform small-loan law constitutes a misdemeanor and permits or requires the supervising official to revoke licenses.

The business is highly competitive and the rates of charge to borrowers of small sums are constantly being decreased as the lending companies develop more efficient methods. Large aggregations of capital have been assembled in the business. Generally speaking, the benefits of large-scale operation are quickly apparent in this business through the reduction of charges to borrowers. The nature of the business is such that money may be lent in small sums to necessitous persons at lower and lower rates in direct proportion to the size of the lending company.

The cash obtained from personal finance companies is almost always used for provident and necessitous purposes rather than for the purchase of luxuries. A careful distinction must be made between these credit agencies which supply cash to meet emergencies or to repay previously incurred obligations on a systematic basis, and those credit agencies which finance the sale of new merchandise on the installment plan. The business of these two types of credit agencies is fundamentally different. Probably 75 percent of the loans by personal finance companies do not create new debts but simply afford those already indebted a means of getting out of debt by amortizing obligations over a reasonable period of time.

The monthly charge of licensed lenders is high by comparison with bank interest. The difference represents the high cost of the labor necessary to handle this special type of lending and the large losses which inevitably accompany it. These loans, which average about \$100 in balance, are repayable in small installments and require a tremendous amount of bookkeeping, collection effort, investigation of credit standing, etc., in proportion to the amount involved. The average net profits of personal finance companies, according to consolidated reports by the banking departments of 15 States, amounted in 1933 to 6.7 percent per annum of the companies' employed assets. This return is barely enough to attract sufficient capital to the business to meet the demand. These authoritative cost and profit studies effectively demonstrate that the aggregate charge to the customer cannot be reduced without discouraging lenders from engaging in the business, thus cutting off a credit service which is essential to urban communities.

"INTEREST" IS NOT "INTEREST"

The small loan laws recognizes that the permitted rate of charge is not solely "interest" on the money lent but rather it is a combination of interest and reimbursement to the lender for the special services rendered and the unusual costs of conducting a business of this character. As frequently stated by the Russell Sage Foundation, the statement of lenders' charges incorporated in the small-loan laws as a simple interest percentage was for the purpose of effective control rather than to express an economic reality. In the days of *unregulated* small loan operations, lenders constantly resorted to investigation fees, charges for execution of papers, fines, penalties, brokerages, commissions, service charges, and other subterfuges in order to disguise the actual rate of charge, to handicap criminal prosecution, and build defense for usury prosecutions. Years of experiment and experience effectively demonstrated the fact that the only effective way to regulate lenders' charges was by lumping together every type of charge and fixing a maximum limitation expressed simply in terms of gross percentage per month, computed only on unpaid actual principal balances, and not to be discounted. Inasmuch as this method of computation is the historical method connected with interest (that is, a percent of principal per unit of time) the aggregate charge made by personal finance companies has come to be termed "interest." In contemplation of law it probably is "interest" in the technical sense because there is no effective means of proving exactly how much is "compensation for the use or forbearance of money," and how much is reimbursement for special disbursements in and about the particular loan. As a practical matter, the lion's share of the charge is not "interest" in the technical sense.

II. Purpose and effect of section 351 of the 1934 Revenue Act

This section imposes a penal surtax on the undistributed net income of personal holding companies. It provides for the collection of a special surtax of 30 percent on the first \$100,000 plus 40 percent of the amount in excess thereof of the undistributed adjusted net income of every personal holding company. In computing the undistributed adjusted net income 20 percent of the adjusted net income may be deducted together with amounts used or set aside to retire indebtedness incurred prior to January 1, 1934, and also dividends paid during the year.

Briefly, a personal holding company is defined as any corporation (other than exempt corporations), banks or trust companies, life insurance companies, or surety companies, at least 80 percent of whose gross income is derived from "royalties, dividends, *interest*, annuities, and, except in the case of regular dealers in stocks or securities, gains from the sale of stock or securities", and more than 50 percent in value of whose outstanding stock is directly or indirectly owned by or for not more than five families. "Families" are defined to include brothers and sisters of the whole or half blood, spouses, ancestors, and lineal descendants.

The purpose of section 351 is solely to prevent surtax avoidance by those who store up investments under corporate ownership and permit the income to accumulate.

While the foregoing purpose is well known, it would be well to note the following quotations from the report of the Senate Committee on Finance, no. 558, dated March 28, 1934. Attention is also directed to the careful distinction constantly drawn between *operating* companies and mere holding companies, a forceful example of which occurs in the second paragraph quoted below. (Italics ours.)

"Your committee is of the opinion that it is extremely important to prevent this type of tax avoidance. While agreeing with the general method proposed

in the House bill to remedy this situation, it is believed that section 102 of the House bill dealing with personal holding companies imposes a heavy penalty on many companies *which do not properly fall into the classification of the 'incorporated pocketbook.'* In view of this situation, your committee has rewritten the section dealing with personal holding companies and has placed it in title IA, section 351, and it has been made plain that this is an additional graduated income tax, or surtax, on personal *holding* companies.

"The House bill includes in the income within the 80-percent clause income from 'rents.' A great part of real estate business is done by small family corporations. *These partake more of the nature of operating companies than mere holding companies.* Your committee is of the opinion that it is unwise to include such companies within the category of personal holding companies. *Therefore, the word 'rents' is omitted from the definition.*

"Many will consider the surtax imposed on these personal holding companies a harsh measure. However, a corporation which falls within this section because of the nature of its business and the number of its stockholders can always escape this tax by distributing to its stockholders at least 80 percent of its adjusted net income. The stockholder will, of course, be subject to the graduated surtaxes upon such distributions. Thus, the section should work no real hardship upon any corporation *except one which is being used to reduce surtaxes upon its shareholders.*

"It is believed that the majority of these corporations are in fact *formed for the sole purpose of avoiding the imposition of the surtax upon the stockholders.*

"Your committee believes that the imposition of a surtax on personal holding companies *created to defeat the operation of the surtax* on individuals is of the utmost importance and that it will result, directly or indirectly, in substantially increasing the revenues of the Government."

The essential features of a personal holding company within the intention of Congress are, first, a concentration of ownership, facilitating dividend manipulation, and, second, the type of income which arises from investments or income-producing property as such (as distinct from income arising from operations or efforts).

III. Distinction between "operating" and "holding" companies

It is at once obvious that section 351 cannot properly be applied to *operating* companies. The essential tax problem which section 351 is designed to answer does not exist and cannot exist in an *operating* company. The provisions of section 102 (1934 act) cover the improper accumulation of surplus by all corporations *other than personal holding companies.*

The basic nature and problems of an *operating* company are vastly different from those of a holding company, personal or otherwise, particularly from the tax viewpoint. An *operating* company requires the accumulation of a reasonable amount of surplus.

An *operating* company has necessities which do not exist in the case of a mere holding company. *Operating* companies have extensive and inflexible pay rolls, heavy overhead, and large expenses for materials and efforts which must be met. They must be prepared to face changes in styles, operating methods, materials, etc. Their success depends upon constant industry and resourcefulness, adequate financing, ability to meet changing conditions, etc. They must face the many hazards and vicissitudes of the commercial field in which they are engaged. Their gross income results in part from the employment of capital but largely from the efforts of management and labor; their net income consists of the margin between their gross income and their total costs for effort and material, including processes. Holding companies, on the other hand, have relatively small pay rolls, overhead, and general expenses; they need exercise only an investor's judgment; their costs, processes, efforts, and material charges are low in proportion to their gross income; their gross and net income arise almost wholly from the employment of capital. Thus holding companies need not accumulate large reserves or surplus against hazards and changes of business, *their assets being really one large reserve.* Generally speaking, the only use to which holding companies can put surplus accumulations is for further and additional investments.

Personal finance companies are required to spend, and do actually spend, more than 50 percent of their gross income for pay rolls, rent, postage, printing, office supplies, bad-debt losses, telephone and telegraph, traveling expense, and numerous other items of overhead which any operating enterprise is compelled to disburse. These expenses often run in excess of 70 percent of the gross income. The

foregoing percentages do not include taxes, interest on borrowed money, reserves for contingencies, capital losses, and numerous other items of like character.

Personal finance companies seldom own any *investments* of stocks, bonds, or any other securities. Their assets are usually confined to office furniture, and equipment, cash on hand, and their notes receivable, practically unsecured, due from individuals (natural persons only) and usually averaging from \$75 to \$120 per account. The accounts run from \$300 down to \$1, depending upon the number of installments of principal already paid.

Personal finance companies are compelled to employ about 1 person for every 250 open accounts. Their ability to operate at all depends upon the skill and experience of trained employees of a high degree of ability in this specialized field. A large part of the overhead of personal finance companies is fixed, such as rents and employees under labor contracts. The bad-debt losses of these companies are large. They vary usually with the commercial and employment conditions in the various localities in which they operate and among the various classes of employed persons who are indebted to them.

Inasmuch as the business is dependent upon legislative franchise and licenses are subject to revocation, often in the discretion of the supervising official, there is a real hazard from which two results follow, viz, (1) the necessity to pay investors a somewhat larger return than in the more stable businesses and (2) the necessity to build up an adequate reserve against the possibility of liquidation losses at any time.

The laws of a number of the States and the regulations of the supervising officials indicate conclusively the operating character of these personal finance companies. They demonstrate the fact that the gross charge of the lenders is made up largely of reimbursement for special expenses required by the nature of the business. For example, the uniform small loan law of Tennessee provides for an aggregate interest of one-half percent per month and maximum aggregate charge for disbursements of 3 percent per month. The law of Massachusetts refers to charges "for interest and expenses", and the supervisor of small loan agencies under the Massachusetts law, in fixing the aggregate rate of charge, uses the language: "The total amount to be paid on any loan for *interest and expenses* shall not, in the aggregate, exceed an amount equivalent to 3 percent a month on the amount actually received by the borrower, computed on unpaid monthly balances." There are numerous other illustrations of the same legislative recognition of the economic reality that the "interest" charge of small loan companies is both "interest and other charges."

The definition of personal holding companies in section 351, while intended to apply the penal surtax only to "incorporated pocketbooks", in fact extends the surtax to include at least this one type of *operating* company. This works a major hardship on a large industry which is economically sound and socially wholesome. There is no relief from this unfortunate situation without a curative amendment, because the technical definition of the word "interest" (in contemplation of law) includes the gross income of personal finance companies licensed under the uniform small loan law.

The misdefinition occurs through the peculiarities of the word "interest", which was clearly intended by the drafters of section 351 to include the return on investments in the economic sense rather than the product of industry, skill, and effort, viz, the income of an *operating* company.

Reference is here made again to quotations from the Senate Finance Committee report, which illustrate the true intent of section 351. The Senate Committee on Finance clearly stated that it did not wish to impose a penalty on operating companies, but rather to penalize the "incorporated pocketbooks." It was with this policy in mind that "rents" was stricken from the section. The reason for this action was given that the real-estate business is "more of the nature of operating companies than mere holding companies."

Personal finance companies are the creatures of a special statute. Principally for the sake of effective regulations and, secondly, to impress borrowers with the total cost of their loans, this statute uses the word "interest" to describe a charge paid by the borrower, only a small part of which is interest in actual fact. The bulk of the charge is really a reimbursement to the lender for special out-of-pocket expenditures peculiar to loans of this kind. The operating figures of the small loan companies show that approximately 60 percent of their gross income is consumed by the costs of investigating, making, and collecting the loans.

The records show that no small lender has taken out a license to engage in this highly specialized business for the purpose of avoiding the imposition of surtaxes. To the contrary, it requires a high degree of operating efficiency for a lender to

make sufficient profit to subject his income to any surtaxes. The decline in the number of companies engaged in the personal finance business in most of the States has been marked during the past 4 years, clearly indicating the degree of operating skill necessary to engage successfully in this business.

In no sense is the income of a personal finance company a return on an "investment"; to the contrary, it is the gross income of an operating company which holds nothing.

A personal finance company has to get out and hustle for every penny of its gross income. It is about as far from an "incorporated pocketbook" as can be imagined. Its expenses, hazards, necessities, and problems are strictly those of an operating company. Its gross and net income are derived more from its efforts than from its capital. The continued application of section 351 will ruin personal finance companies and bring to a close a broad remedial program of great importance.

As the first uniform small loan law was passed in 1915, the personal-finance business is a relatively new business. Most of the companies in the business are only now emerging from the "closed corporation" stage. While some of the larger units have securities listed on the large stock exchanges, it is still possible to bring them within the 5-family rule of section 351 by adding together a sufficient number of individuals. Thus a large number of personal finance companies fall within the 5-family rule, although in fact their management is by no means concentrated. To illustrate, one of the largest companies with one class of stock listed on the New York Stock Exchange has more than \$10,000,000 of this stock held by over 2,400 different persons in 43 States and insular possessions and 7 foreign countries. In addition, it has approximately 500 common stockholders, largely drawn from among its 1,400 employees and executives. Yet by adding together more than 20 individuals in 5 family groups, it falls within the 5-family rule. Many of the individuals in these family groups have never met many of the others, and there is no business cooperation or personal contact between most of them. On a smaller scale the same situation exists with many others of the personal-finance companies.

IV. No remedy under section 351

The Senate Finance Committee said that a company "can always escape this tax by distributing to its stockholders at least 80 percent of its adjusted net income." This statement is fallacious when applied to personal finance companies:

1. The *commercial income* of personal finance companies is always considerably less than the "adjusted net income" under the definitions of section 351. As in every operating business there are frequently recurring large disbursements and reserves which must actually be provided for out of income in addition to the deductions permitted in computing taxable income. The result is that section 351 actually compels the distribution, on an average, of from 90 to 95 percent of the commercial net income of personal finance companies. In 1934 there were several actual cases where section 351 compelled the distribution of almost 200 percent of the commercial net income of a personal finance company, as computed by sound and recognized accounting practices applicable to such companies. Because of the foregoing, few, if any, personal finance companies could, under section 351, actually accumulate as much as 20 percent of their true net income in any one year. This is the case because these companies are faced with the problems of operating companies rather than the problems of mere holding companies. The investment portfolio of a holding company may grow or shrink without serious reactions, but an operating company must stay sound or collapse entirely.

2. Even the provision permitting the deduction of amounts "used or set aside" to retire indebtedness incurred prior to January 1, 1934, is almost nugatory in its application to personal finance companies. Most of these companies are compelled by reason of their recent origin to operate in part on short-time credit, usually money borrowed from banks on 90-day notes. All of the large personal finance companies utilize such bank credit as part of their employed capital. The regulations of the Treasury Department (TD4503) do not permit the deduction of amounts used to pay such floating debt. Even if they did, this deduction would only be open to such companies in the year 1934. It is submitted that in this respect again the difficulty arises from the difference between operating and holding companies. Liquidation of debts would be a minor problem to a holding company which simply exists with a portfolio of investments which can be sold to retire a debt. Such liquidation would be disastrous to an

operating company such as any of the personal finance companies. Under the provisions of section 351 a personal finance company cannot accumulate any substantial amount of money from current earnings—earnings must be distributed or subjected to a penal surtax. A personal finance company would be compelled to obtain money to pay its debts, either through the sale of new securities (a disruptive, expensive, and often impossible method) or by the partial liquidation of its loan account. The latter alternative would be disastrous because a high proportion of such a company's overhead is fixed in leases and pay rolls; any undue liquidation of its loan account would create a disparity between its gross income and its operating expenses which, in turn, would eliminate its net income.

3. It is necessary for a personal finance company to build up an adequate surplus to carry it over bad times, meet fixed overhead in periods of low gross income, attract new capital, meet unusual losses, and for all the other exigencies which may affect the operation of any commercial company. Commercial bank credit is not open to operating companies which pay out all of their earnings in dividends. The well-established rule among banks is for a commercial business to pay out in dividends a maximum of not more than two-thirds of such company's *commercial earnings* and to add the remaining one-third to surplus either for subsequent capitalization or to provide a buffer against the recurring emergencies of business operations. Any operating company which is required by law to distribute annually practically all of its commercial net income cannot remain in a sound financial condition. The inevitable consequence which would develop soon with some companies and eventually with all companies would be an unsound financial condition resulting in a loss of employed capital and the ultimate withering or collapse of such concerns.

It is strongly restated that the continued application of section 351 to personal finance companies will inevitably injure and ultimately destroy them, and thus immediately limit and eventually prevent the development of a remedial movement sponsored by the best philanthropic and social agencies in this country and now developing to the benefit of the public.

V. Suggested remedy

In order to eliminate these operating personal finance companies from the penal surtaxes imposed by section 351 without creating a means of tax avoidance for any mere holding companies or for actual "incorporated pocketbooks," the following simple amendment to section 351 is proposed (*italics new*):

"The term 'personal holding company' means any corporation (other than * * *) if (A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest (*except lawful interest received from an individual on an indebtedness which did not exceed \$300 in aggregate principal amount owing to such corporation by the same debtor, at any time during the taxable year*), annuities, and (except * * *) gains from the sale of stock and securities, and * * *"

An alternative to the foregoing new language is:

"(except lawful interest received from an individual whose indebtedness to such corporation did not at any time during the taxable year exceed \$300 in principal amount)".

It will be noted that only interest received from natural persons on loans up to \$300 in principal amount is exempt. This language would not permit manipulation of any business in such a manner as to allow tax avoidance by a company which is actually a holding company. The language is simple and logical. It uses a method which distinguishes between a true "investment" income, largely composed of pure interest, and an entirely different income, namely the profit from an operating enterprise, only a small part of which is pure interest. The notes of a small loan company, being of such minute size and due from a natural person, cannot be an *investment*; nor are they something worth *holding* in the sense that either of these words is used in section 351. Such debts cannot be *held* at all, if any value is to be derived from it. They must be *collected* by constant affirmative effort and at very high proportionate expense. If any company is engaged in making such loans as a business, its expenses will automatically be high and its risks and losses large; that is to say, it will be an operating company and not within the intended or justifiable purview of section 351. If any company holds such a debt casually, that fact does not alter its true character as an incorporated pocketbook.

The language suggested is broad and its operation is inescapably sound from the tax viewpoint because it distinguishes on the basis of economic reality between investments and a type of property necessarily involving the essential factors of an operating enterprise.

The use of the word "lawful" in the curative language effectively prevents the application of this exemption to "loan sharks" or others engaged in unlawful credit operations.

The uniform small loan laws vary widely in their method of enforcement, nomenclature, and the distinguishing characteristics which might otherwise be utilized to describe the business. Thus there is no other safe and accurate general differentiating characteristic which may be used in an exempting proviso to exclude companies and debts of this character. A large number of suggested amendments have been analyzed and all of them have seemed unsafe or inaccurate or illogical because of one of more factors.

Congress has already recognized the principles set forth in the statement and applied them in the present section 351. The present section exempts banks, life insurance companies, surety companies, and dealers in stocks or securities, each of which presents one or more of the essential reasons for exempting personal finance companies; or, stated more accurately, for exempting from the definition the gross income of personal finance companies which is labelled "interest" but which is actual fact consists largely of an entirely different type of income.

An even more persuasive or analogous application of these principles occurred when the word "rents" was eliminated from the House bill for the specific reason that companies deriving income from rents "partake more of the nature of operating companies than mere holding companies. * * * It is unwise to include such companies within the category of personal holding companies."

Respectfully submitted.

ELLSWORTH C. ALVORD,

Counsel for American Association of Personal Finance Companies.

The CHAIRMAN. Congressman Ellenbogen, the committee will be glad to hear you at this time.

STATEMENT OF HON. HENRY ELLENBOGEN, REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. ELLENBOGEN. I will just take a few minutes.

Mr. Chairman and members of the committee, I desire to present an amendment to the pending tax bill, which is very brief, and which I want to hand to the Chair.

The CHAIRMAN. You may give it to the clerk there, please. Now you may proceed.

(The amendment offered by Mr. Ellenbogen is as follows:)

Page 59 after line 4, add a new section as follows:

SEC. 401½. *Proceeds of insurance used to pay inheritance or estate taxes.*—There shall be exempt from the inheritance tax imposed by this title, from the estate tax imposed by title III, as amended, of the Revenue Act of 1926, and from the additional estate tax imposed by title II, as amended, of the Revenue Act of 1932, such part of the proceeds, not in excess of \$750,000, of any insurance policy taken out by the decedent upon his own life, as is directed by the decedent to be used and is actually used for the payment of such taxes.

Mr. ELLENBOGEN. I want to address myself solely to the question of estate and inheritance taxes as contained in the bill.

I have in mind the case of a business man who has a fair-sized business, not a very large business but a fair-sized business, and no liquid assets, and desires to leave that business to his children and next of kin, and when he dies it is found that the liquid assets, cash or bonds or stocks, are by far insufficient to pay the estate tax, and certainly insufficient to pay the inheritance tax that is levied in this bill. In

such a case the business would have to be sacrificed, be sold out to a competitor, or be sacrificed and sold at small value. The Treasury would not receive any tax, and the children and next of kin would not receive any estate.

The same applies to the case of a person who has large holdings of real estate and no liquid assets that cannot be sold quickly, or maybe not be sold over a number of years. Therefore, I propose, Mr. Chairman, an amendment permitting the deceased to take out insurance upon his own life, limited in amount, and to the extent that the insurance is used to pay the estate tax assessed in prior laws, or the inheritance tax assessed in title II of this act, and only to that extent should the proceeds of the insurance policy be free from the estate and inheritance tax. And I propose that the total amount of such insurance which may be tax-free be limited to \$750,000.

For instance, if one should have a policy of \$500,000, and the estate and inheritance tax would only take up \$300,000 then only \$300,000 would be exempted from this tax, and the balance that goes into the estate would be taxed.

I think if that is put into the bill, Mr. Chairman, you would allay the fear of thousands upon thousands of people of the middle classes.

The CHAIRMAN. Congressman, the committee will give your suggestion every consideration.

Senator KING. Let me ask you just one question. Suppose when the deceased, when the man died, who had this policy, he had no liabilities, his assets were free from liens what would you say then as to the power to tax, or the right to tax the amount derived from his paid-up policy of insurance?

Mr. ELLENBOGEN. I believe, and the amendment so provides, that only such a portion of the insurance policy proceeds as are paid to the United States as a tax shall be free from the estate or inheritance taxes. Any part of the policy that goes into the estate should be taxed, but if it goes into the payment of the tax to the Government then to that extent paid, I suggest it be tax-free.

Senator KING. Yes.

The CHAIRMAN. Thank you very much, Congressman Ellenbogen.

Mr. Charles C. Mayer. Mr. Mayer, the committee will give you 5 minutes.

STATEMENT OF CHARLES C. MAYER, REPRESENTING THE E. P. I. C. SOCIETY OF CALIFORNIA, WASHINGTON, D. C.

Mr. MAYER. Mr. Chairman and Senators, I appear for the E. P. I. C. Society of the Pacific coast, whose policy is production for mutual use and mutual profit rather than for monopoly profit.

Only through taxation, more taxation, and still more taxation will it be possible to continue and get our one hundred and twenty-odd million people off of a dead level we have been on for so many years.

The Supreme Court points the way in the closing sentence of its decision on the Frazier-Lemke bill in these words:

If the public interest requires and permits the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain so that through taxes the burden of relief afforded in the public interest may be borne by the public.

An adequate, responsive, and responsible tax system, which the pending bill begins to approach, must depend upon an adequate, responsible, and honest constitutional money system, which the banking act now in conference between the House and Senate promises to initiate.

We are told twelve or thirteen million citizens participate in corporation dividends. This leaves 112,000,000 or more, who include the 80 percent Senator Borah says are on the borderline of poverty.

Tens of millions of Americans have been increasingly driven toward a condition of being untouchables, becoming pariahs, who are herded within the pale of poverty.

Tax reforms and money reforms must be developed to succor over 100,000,000 citizens disfranchised economically and partly pauperized.

We are told by Professor Fairchild yesterday 350,000 people more or less in recent years, one-third of 1 percent of all our citizens, have incomes of \$5,000 upward on which they pay taxes. Only 1½ million people, a little over 1 percent of all, paid income tax in 1933. This situation leaves nearly 95 percent of all Americans below the \$2,500, or \$2,000 standard of living the President, the Brookings Institute, and others calculate is necessary—1½ million representing 6 million people.

Adequate tax measures and adequate money measures only can correct these conditions.

The mayor of Pittsburgh yesterday worries about deflating the cash resources of his city through the pending tax measure.

A tax bill must be based on the Government's current conception of money.

Taxes cannot be collected unless money circulates adequately or is made to do so.

Cash capital or lawful money is created only by sovereign authority of the Government. It is being widely conceded that revenue and cash capital can be legally secured only by the fiat of Government issued against taxable wealth and against anticipated tax revenue from sure sources, such as the telephone, power company, gasoline, cigarette, alcohol, and other taxes.

Lawful money is not created by private credit inflations. Inflations that are mounting above an existing figure of 200 billions of values now in circulation are reaching out toward a total of 300 billions of values that were in circulation at the peak period of our so-called "Golden Age of Prosperity." These figures do not account for the one hundred billions of so-called "insurance" in force that the insurance boys told us yesterday was a contingent liability against all the insurance companies.

Fallacious notions about tax collections from Ford or like estates are due to fallacies about the creation of money. Government needs only to authorize a conservative issue of bonds against any claim and issue cash against the bonds to be liquidated over a period of years, exclusively through the Treasury Department, earmarking and holding both bonds and impounded money in United States Treasury vaults.

I would like to offer for the record a brief statement on how "to minimize or offset the lack of lawful money."

The CHAIRMAN. All right; you may put that into the record.
(The statement referred to is as follows:)

TO MINIMIZE OR OFFSET THE LACK OF LAWFUL MONEY

Failure of Congress to expand the amount of lawful money in circulation in all the States does not prevent any one or more States from expanding its own money tokens or special currency in the same manner that private banks and bankers increase circulation.

Those States that declared moratoriums actually expanded the use of mortgage money and money tokens by extending the life and use of the existing money tokens and mortgage-payment paper one or more years, regardless of insurance companies, mortgage houses, and other bankers.

"No State shall coin money," says the Constitution. However, any State can put more currency in actual circulation through State certificates of deposit or State treasury due bills, or negotiable certificates and checks exactly as banks and bankers issue their money substitutes.

Expanding the currency in the use of any one State would help all the State bankers, merchants, farmers, laborers, and all classes of society.

It is proposed in several Western States to deposit all United States money used in each State for pay-roll purposes and to issue the State's receivable certificates in exchange for same, each month for a period of months.

Under this plan State certificates, or due bills, or treasury checks can be issued in amounts of \$1 or more, payable or redeemable in United States lawful money on or before 6 months from date of issue.

This State currency would require the endorsement of a dozen or more citizens before it could be retired from use and redeemed by the State treasurer prior to its 6 months due date. In this way the State currency would be kept in circulation for several months up to 6 months, passing in trade to create trade activity and to pay debts.

Pay-roll money usually goes out of circulation a few days after it is disbursed. It goes into hiding or becomes hoarded in vaults until the next pay day rolls around.

Under the proposed plan to increase the use of currency or expand circulation there would be several times as great a volume of money certificates or tokens in use, and every citizen would have a chance to do more business or secure more employment.

With more money in circulation more debts could be paid and much greater business activity would result through a much greater turnover of money in use.

MR. MAYER. I would like to also include a statement of Speaker Byrns of a year ago in the Congressional Record, page 11836, in which he said, "Congress had been modest in its expenditures."

THE CHAIRMAN. All right; you may put that in the record.

MR. MAYER. This statement is part of a lengthy statement I recently offered.

(The statement referred to is as follows:)

I also found that Speaker Byrns, on the 15th day of June, in the Congressional Record, page 11836—I think that is the exact page—said that Congress had been modest in its expenditures compared with its power to secure money. He said that we could issue \$10,000,000,000 of cash legal tender, safe, constitutional money—not in those exact words—and redeem it by laying aside the revenues from alcoholic taxes. On the same basis you could issue any part of 25 billion to 50 billion of dollars by laying aside the excess revenues, after allowing a fair return, to the power interests, on their portion of over a billion dollars of revenue per year—take more than the 3 percent that Congress now collects—after two efforts, through Congress, the first of which was beaten in conference by Mr. Crisp of Georgia, who was kept at home because he beat it—and increase that 3-percent revenue up to 50 percent or more, if necessary, and lay that aside, \$500,000,000 a year, and in time you will have enough to liquidate the 25 or more billions of honest legal tender cash.

A fair return—the Supreme Court's last decision is the going value of money. A previous decision was, in the *Baltimore Rate case*, 7.46 percent. The Treasury Department has been trying to fix it at 2½ percent, one-third of 7.46 percent. If the utilities are allowed to earn 2½ percent on a guaranteed basis, then all the revenues between 2½ percent and 7½ percent can be allocated for the use of the people of the United States, whose wealth it is. They produce that wealth.

Mr. MAYER. And I have a few other statements here which I would like to submit, one entitled "200 billions deflation destroyed prosperity."

The CHAIRMAN. I cannot fill up this record with newspaper items, but I would be very glad to have Speaker Byrns' statement go in there.

Mr. MAYER. And then I have another short statement which I would like to submit.

The CHAIRMAN. All right, sir; you may do that.

(The statement referred to is as follows:)

TWO HUNDRED BILLIONS' DEFLATION DESTROYED PROSPERITY—SHORTAGE OF MONEY CLOSED EVERY BANK IN AMERICA

Shortage of money and money tokens amounted to a total of 200 billions dollars in recent years.

Over 100 million Americans were deflated and crippled financially by the withdrawal from circulation of 200 billions of dollars and dollar values. These dollar values were represented by bank deposits and resources, home mortgages, real-estate bonds, and other stocks and bonds and negotiable instruments.

At the peak of our boom period there were over 300 billions of money tokens, instruments, and values in active trade and circulation.

The contraction or deflation of 300 billions to an approximate 100 billions, between October 1929, and July 1932, comprehends all the hell the American people have been through since 1929.

When 200 billions were taken out of circulation there were communities in all 48 States that resorted to barter because Congress failed in its constitutional duty to "coin money", required by all citizens in all 48 States.

Failure of Congress to provide a sufficient supply of money coinage for all 48 States is outlined conclusively in Senator Nye's address in the Congressional Record of July 25, 1935. Senator Nye repeatedly cites violation of the Constitution by Congress regarding its "coin money" powers. Senator Thomas, Oklahoma, and Senator Borah also referred to Constitution evasions, in debating the Banking Act.

There is more misunderstanding and seeming indifference regarding money and the most vital, fundamental power of Congress, than on any other subject.

Senator Fletcher, July 26, said:

"We are making history here and we can't even get Senators on the floor to vote * * * in several periods of debate we didn't even have a quorum."

The Treasury Department reports:

"The public debt in 1916 was \$1,225,145,568, or \$11.96 per capita."

The public debt is calculated to reach \$34,239,000,000, a per capita charge of \$273.09, in 1936.

We have been traveling toward the road to bankruptcy. Debts must be drastically reduced through adequate taxation. There is no other way out toward recovery. "National debts paying interest are merely the purchase by the rich of the power to tax the poor," said John Ruskin.

The CHAIRMAN. Mr. Walter E. Barton. Mr. Barton, how much time do you want?

Mr. BARTON. I would like to have about 10 minutes.

The CHAIRMAN. All right. You may proceed.

**STATEMENT OF WALTER E. BARTON, ATTORNEY AT LAW,
WASHINGTON, D. C.**

Mr. BARTON. I am not representing any organization. I am representing myself and other life-insurance policyholders. I understand there are about 119,000,000 different life-insurance policies in force, and about 63,000,000 different people insured.

I want to call your attention to three different phases of the inheritance-tax bill, merely from the life-insurance standpoint.

First, section 203(a)(7) of the bill, which I believe will work an irreparable hardship on many thousands of policyholders in this country, who have been struggling during all of these years to carry their insurance.

Section 302 (g) of the present law, taxes all life insurance that is payable to a man's estate, and all in excess of \$40,000 that goes to some other beneficiary. This exemption of \$40,000 in the estate-tax law is a recognition of the great social and economic value of life insurance. It is an encouragement to the citizens of this country to carry life insurance for the benefit of their families. The pending inheritance tax bill, however, does not offer the same encouragement. It provides that the entire proceeds of life insurance without any exemption of such proceeds whatsoever shall be included in the amount taxable to the beneficiary, irrespective of whether the proceeds are payable to his estate or to some other beneficiary.

Life insurance is the basic estate, representing to the widow and the orphan that part of the earning power which the husband and father is able to perpetuate beyond the grave. It enables the family to retain the home, furnishes them with food and shelter, and sees the children through school, and in many instances, keeps them from becoming dependent upon private or governmental charity. It always has been regarded as a special kind of property, not being a part of an insured's estate and not being subject to the payment of his debts.

I have on page 2 of my memorandum excerpts from statements made by Presidents of the United States, beginning with Grover Cleveland, and coming up to date, except I believe there is nothing from President Taft.

I think the finest statement perhaps is made by President Coolidge. It is very brief. I should like to read it. President Coolidge said:

Insurance is the modern method by which men make the uncertain certain, and the unequal equal. It is the means by which success is almost guaranteed, It is part charity, and part business, but all common sense. Through its operations, the strong contribute to the support of the weak, and the weak secure, not by favor, but by right, duly purchased and paid for, the support of the strong. Every insurance policy is a declaration of independence, a charter of economic freedom. He who holds one has overcome adversity.

The principle upon which this proceeds is all very plain. It has its foundation in thrift. Every one knows that it is not what is earned, but what is saved, which measures the difference between success and failure. This is a difference so slight from day to day as to seem unimportant and of no consequence, but in the aggregate of even a few years, it amounts to a sum of great importance. The ability to save is based entirely upon self-control. The possession of that capacity is the main element of character. It passes over at once into the realm of good citizenship. He who sells an insurance policy sells a certificate of character, and evidence of good citizenship, an unimpeachable title to the right of self-government.

I am submitting the statements as to insurance of the other Presidents.

(The statements referred to are as follows:)

Grover Cleveland: "Get a policy, and then hold on to it. It means self-respect, it means that nobody will have to put something in a hat for you or your dependent ones if you should be snatched away from them."

Theodore Roosevelt: "Life insurance increases the stability of the business world, raises its moral tone and puts a premium upon those habits of thrift and savings which are so essential to the welfare of the people as a body."

Woodrow Wilson: "If a man does not provide for all those dependent upon him—then he has not opened his eyes to any adequate conception of human life. We are in this world to provide not for ourselves but for others."

Herbert Hoover: "Insurance offers men and women an opportunity to pool the financial effects of chance misfortunes, and also a good medium for saving and investment. The wide distribution of insurance in this country is an invaluable factor in our daily life, and is, I believe, one of the finest results of our national development."

Franklin D. Roosevelt: "Life insurance should be considered not as an expense, but as savings. It should be the first factor in any program of investment. It should be the last to let go. In hard times, it is especially important, and we should make every effort to keep our old life insurance in force."

"No matter who he may be, or how he may be related to organized society, every normal individual has had thrust upon him certain social obligations. Certain expectations on the part of his fellows have been formulated in advance of his entry; and all thrive in, in its final analysis, an effort to meet those expectations and fulfill those social obligations. Life insurance enables him to do that to the fullest and with the greatest ease and certainty."

Mr. BARTON. The rates on inheritances should not discourage the citizen from keeping up his present insurance or deter him from taking out additional amounts. The decision to carry or to discontinue life insurance will be determined by the amount of the proceeds that actually shall be received by the beneficiary of the policy after the necessary taxes are paid. If the law requires too great a percentage of the proceeds to be paid to the Government after the death of the insured, the natural conclusion of the insured will be that the penalty is too great to carry insurance of any consequence. It is my humble opinion that the rates imposed by the pending bill exact such a large percentage of tax that many policyholders will conclude that it is not worth while to make the necessary sacrifices to pay premiums on their present insurance, and that many persons will be deterred from taking out new or additional insurance as long as the proposed rates are in force.

I believe you have before you some tables. If you will be good enough to look at them, I should like to call your attention to the effect of this bill on certain policies. Now, in preparing these tables I take into consideration the general property exemption of \$50,000 that is allowed in the estate tax bill, and the \$50,000 general property exemption that is allowed in the proposed bill, and also take into consideration the \$40,000 exemption of life-insurance proceeds.

In table A the first net estate considered is one of \$50,000, which under the present estate tax law and under the proposed inheritance-tax bill would be totally exempted. The next line, however, shows this same \$50,000 estate with a \$50,000 life-insurance policy in addition. The estate tax on that would be \$100, but the inheritance tax proposed by this bill that would be payable solely on account of that life insurance is \$5,684, and that amounts to a total tax of 11.37 percent of the life insurance.

I have carried those tables on down with net estates of various amounts to \$1,000,000 and adding insurance proceeds of \$50,000, and you will observe that on a \$1,000,000 estate, in the last line, the estate tax is \$2,500 on a \$50,000 policy under the present law, but that the inheritance tax would be \$19,000 additional under the proposed law, or a total tax of \$21,500, or 43 percent on a \$50,000 policy.

The next table, table B, takes the same estate with a policy of \$100,000, and there you will observe in the second line that such a policy under the present estate tax law would pay \$2,200, and under

the proposed inheritance tax law it would pay an additional tax of \$15,160, or a total tax on account of \$100,000 insurance of \$17,360, or 17.36 percent. And carrying that on down I have shown that on a million dollar policy the estate tax on \$100,000 life insurance—it is about the fifth column—is \$15,300 under the present law, but under the proposed law there would be an additional tax of \$33,880, or a total tax of \$49,180, or 49 percent plus.

It seems to me that life insurance is the kind of property that should be totally exempt in the inheritance tax law that is now proposed. It has always been considered as a special kind of property, not belonging to the decedent's estate, not being subject to his debts.

If the committee, however, should not agree to that it seems to me that certainly there should be an exemption of \$40,000 to each beneficiary in the new bill. And I have shown in table C what the effect of such an exemption of \$40,000 would be. That shows that in the case of a net estate of \$50,000 and in addition a \$50,000 life-insurance policy, with a \$40,000 exemption there would be \$376 inheritance and estate taxes, and carrying that down to \$1,000,000 upon a \$100,000 policy the taxes would be \$33,180, or 33.18 percent. That is a very high rate even with a \$40,000 exemption.

The CHAIRMAN. You may put those tables in the record.

(The tables referred to are as follows:)

TABLE A

1	2	3	4	5	6					
					Additional taxes on account of insurance					
					Estate tax		Inheritance tax		Total taxes	
Net estate exclusive of insurance	Insurance in addition to 1	Estate tax on 1 and 2	Inheritance tax on 1 and 2	Total estate and inheritance taxes on 1 and 2	Amount	Percent of tax to insurance	Amount	Percent of tax to insurance	Amount	Percent of tax to insurance
\$50,000.....	None	None	None	None	100	0.20	5,584	11.17	5,684	11.37
\$50,000.....	\$50,000	\$100	\$5,584	\$5,684	700	1.40	9,800	19.60	10,500	21.00
\$100,000.....	None	1,500	5,360	6,800	1,200	2.40	13,200	26.40	14,400	28.80
\$100,000.....	50,000	2,200	15,160	17,360	1,600	3.20	14,464	28.93	16,064	32.13
\$200,000.....	None	11,600	24,816	36,416	1,600	3.20	15,488	30.98	17,088	34.18
\$200,000.....	50,000	12,800	38,016	50,816	1,900	3.80	16,952	33.90	18,852	37.70
\$300,000.....	None	25,600	48,432	74,032	1,900	3.80	17,316	34.63	19,216	38.43
\$300,000.....	50,000	27,200	62,896	90,096	2,200	4.40	17,208	34.42	19,408	38.82
\$400,000.....	None	41,600	74,288	115,888	2,200	4.40	17,208	34.42	19,408	38.82
\$400,000.....	50,000	43,200	89,776	132,976	2,500	5.00	19,000	38.00	21,500	43.00
\$500,000.....	None	59,100	100,688	159,788	2,500	5.00	19,000	38.00	21,500	43.00
\$500,000.....	50,000	61,000	117,640	178,640	2,500	5.00	19,000	38.00	21,500	43.00
\$600,000.....	None	78,100	129,484	207,584	2,500	5.00	19,000	38.00	21,500	43.00
\$600,000.....	50,000	80,000	146,800	226,800	2,500	5.00	19,000	38.00	21,500	43.00
\$700,000.....	None	98,600	158,104	256,704	2,500	5.00	19,000	38.00	21,500	43.00
\$700,000.....	50,000	100,800	175,312	276,112	2,500	5.00	19,000	38.00	21,500	43.00
\$800,000.....	None	120,600	186,184	306,784	2,500	5.00	19,000	38.00	21,500	43.00
\$800,000.....	50,000	122,800	203,392	326,192	2,500	5.00	19,000	38.00	21,500	43.00
\$900,000.....	None	144,100	213,960	358,060	2,500	5.00	19,000	38.00	21,500	43.00
\$900,000.....	50,000	146,600	232,960	379,560	2,500	5.00	19,000	38.00	21,500	43.00
\$1,000,000.....	None	169,100	243,960	413,060	2,500	5.00	19,000	38.00	21,500	43.00
\$1,000,000.....	50,000	171,600	262,960	434,560	2,500	5.00	19,000	38.00	21,500	43.00

TABLE B

1	2	3	4	5	6					
					Additional taxes on account of insurance					
					Estate tax		Inheritance tax		Total taxes	
Net estate exclusive of insurance	Insurance in addition to 1	Estate tax on 1 and 2	Inheritance tax on 1 and 2	Total estate and inheritance taxes on 1 and 2	Amount	Percent of tax to insurance	Amount	Percent of tax to insurance	Amount	Percent of tax to insurance
\$50,000-----	None	None	None	None						
\$50,000-----	\$100,000	\$2,200	\$15,160	\$17,360	2,200	2.20	\$15,160	15.16	\$17,360	17.36
\$100,000-----	None	1,500	5,360	6,800						
\$100,000-----	100,000	6,800	25,968	32,768	5,300	5.30	20,608	20.61	25,908	25.91
\$200,000-----	None	11,600	24,816	36,416						
\$200,000-----	100,000	19,200	50,224	69,424	7,600	7.60	25,408	25.41	33,008	33.01
\$300,000-----	None	25,600	48,432	74,032						
\$300,000-----	100,000	35,200	76,336	111,536	9,600	9.60	27,904	27.90	37,504	37.50
\$400,000-----	None	41,600	74,288	115,888						
\$400,000-----	100,000	51,500	103,120	154,620	9,900	9.90	28,832	28.83	38,732	38.73
\$500,000-----	None	59,100	100,688	159,788						
\$500,000-----	100,000	70,500	132,220	202,720	11,400	11.40	31,532	31.53	42,932	42.93
\$600,000-----	None	78,100	129,484	207,584						
\$600,000-----	100,000	89,800	161,272	251,072	11,700	11.70	31,788	31.79	43,488	43.49
\$700,000-----	None	98,600	158,104	256,704						
\$700,000-----	100,000	111,800	189,352	301,152	13,200	13.20	31,248	31.25	44,448	44.45
\$800,000-----	None	120,600	186,184	306,784						
\$800,000-----	100,000	134,100	217,960	352,060	13,500	13.50	31,776	31.78	45,276	45.28
\$900,000-----	None	144,100	213,960	358,060						
\$900,000-----	100,000	159,100	247,960	407,060	15,000	15.00	34,000	34.00	49,000	49.00
\$1,000,000-----	None	169,100	243,960	413,060						
\$1,000,000-----	100,000	184,400	277,840	462,240	15,300	15.30	33,880	33.88	49,180	49.18

TABLE C

(1)	(2)	(3)	(4)	(5)	(6)
Net estate, exclusive of insurance	Insurance in addition to (1)	Total estate and inheritance taxes on (2) under present bill	Percent of (3) to (2)	Total estate and inheritance taxes on (2) if \$40,000 exemption allowed	Percent of (5) to (2)
\$50,000-----	\$50,000	\$5,684	11.37	\$376	0.75
\$50,000-----	100,000	17,360	17.36	9,360	9.36
\$100,000-----	50,000	10,500	21.00	2,500	5.00
\$100,000-----	100,000	25,908	25.91	16,308	16.31
\$200,000-----	50,000	14,400	28.80	3,312	6.62
\$200,000-----	100,000	33,008	33.01	21,808	21.81
\$300,000-----	50,000	16,064	32.13	3,952	7.90
\$300,000-----	100,000	37,504	37.50	24,704	24.70
\$400,000-----	50,000	17,088	34.18	4,288	8.58
\$400,000-----	100,000	38,732	38.73	25,932	25.93
\$500,000-----	50,000	18,852	37.70	4,492	8.98
\$500,000-----	100,000	42,932	42.93	28,532	28.53
\$600,000-----	50,000	19,216	38.43	4,816	9.63
\$600,000-----	100,000	43,488	43.49	29,088	29.09
\$700,000-----	50,000	19,408	38.82	5,008	10.01
\$700,000-----	100,000	44,448	44.45	30,048	30.05
\$800,000-----	50,000	19,408	38.82	5,008	10.01
\$800,000-----	100,000	45,276	45.28	30,240	30.24
\$900,000-----	50,000	21,500	43.00	5,500	11.00
\$900,000-----	100,000	49,000	49.00	33,000	33.00
\$1,000,000-----	50,000	21,500	43.00	5,500	11.00
\$1,000,000-----	100,000	49,180	49.18	33,180	33.18

Mr. BARTON. On page 18 of the bill, section 203 (7) proposes to tax the proceeds of life-insurance policies even though at the time of the decedent's death he did not have the right to change the beneficiary or have any legal incident of ownership.

Let us take a situation where after this law is passed an insured makes an irrevocable assignment of his policy to his wife, including the cash surrender value and all incidents of ownership whatsoever. He would be required to pay a gift tax as donor, she would be required to pay a gift tax as donee, and then when he died she would be required to pay an inheritance tax as a beneficiary on the proceeds of the policy, three different kinds of taxes, and the last tax a tax on property that had already been given away. This is the only class of property in this bill which after having been given away and having paid a gift tax is nevertheless at decedent's death subject to an inheritance tax. That certainly is a very unjust discrimination against life insurance, to put an inheritance tax on it after the double gift tax has already been paid, and exempt all other property from similar triplicate taxation.

On page 30 this bill proposes that the insurance company shall be liable for the tax. Life insurance companies have always prided themselves on paying the life insurance proceeds over almost immediately after death. They realize that it is needed at that time. The effect of this bill it seems to me is going to be that life insurance companies in order to protect themselves will have to hold up the payment of the proceeds perhaps for an indefinite time, or in any event require a bond so that they will be protected, and the administrative feature of it in the best aspect is going to delay payment for a considerable time after the decedent's death, whereas under the present situation it is only 2 or 3 days as a rule until the proceeds are paid.

The CHAIRMAN. Thank you very much, Mr. Barton.

Mr. Wager Fisher? How much time do you wish, Mr. Fisher?

Mr. FISHER. At your pleasure, sir.

The CHAIRMAN. We have to have a little executive session here, and we have to close pretty quickly. Will 10 minutes be sufficient?

Mr. FISHER. Yes, sir.

The CHAIRMAN. You may proceed.

STATEMENT OF WAGER FISHER, OF BRYN MAWR, PA.

Mr. FISHER. Mr. Chairman, my name is Wager Fisher, of Bryn Mawr, Pa. I am appearing as a citizen on behalf of myself and other citizens.

I have been here 3 days, and when I came down here I had very different ideas of what I wished to say to this committee than when I started out this morning. The full import of this tax bill did not come to me for a day or two, and I want to talk on the legality or lawfulness of the bill and the right of the Government to take these taxes under the present 1934 act or under the proposed act.

This taxation seems to me to be unconstitutional on several counts.

Now if in the wisdom of those entrusted by us to administer our public affairs they would see fit to call on us for additional contribu-

tions at this time for the conduct of our Government I would like to say something about the complications of the bill and the burden of it on the individual. We have heard a great deal about corporations and rich men, and all of that sort of thing, in which I am not particularly interested myself, as I am not a rich man, but I did settle my father's estate, who died in 1932, and we listened to Mr. Jackson tell us that the Treasury Department knew of no cases where the imposition of estate or inheritance taxes brought hardship or those things that are complained of unless estates were in debt.

I have been very much impressed and have been wondering what would happen to my wife if I died on my way home, and I would like to lay that before you. I sent a telegram to the executor of my father's estate, which gives taxes that we paid in the way of estate taxes to the State of Pennsylvania and to the Federal Government. Now as I understand this act we would pay three taxes on my death. We would pay one to the State of Pennsylvania, we would pay an estate tax to the Federal Government; and we would pay an inheritance tax on what was left after that; and I would absolutely say to you that my wife would be left penniless.

The CHAIRMAN. You must have a pretty good estate.

Mr. FISHER. There it is [indicating telegram], \$180,000. It is not worth that much now.

The CHAIRMAN. All right. You may proceed, Mr. Fisher.

Mr. FISHER. Now, you take an estate in real estate and there would be no possible way of paying out. Under the inheritance tax on page 10 of this bill we would have to pay out \$15,600 upon a total net value of \$100,000, and upon the rest 24 percent on an additional \$80,000, and there would not be any possible way of doing it, because the thing is all in real estate, consisting of our home and property, and the properties are rented. You cannot sell the property. I have been trying for 3 years to sell some property, and you cannot sell any at any reasonable price, and I should think that the whole thing of these estate taxes and the inheritance taxes is far too complicated. You have got valuations on valuations.

You deal with the State of Pennsylvania. They come in and they say, "Your property is worth so much money." You have no appeal from it. Somebody you do not know goes around and looks at it and says it is worth so much. Then there is another appraiser who comes from the Internal Revenue Department and assesses another valuation. So you have two values fixed. Maybe you make a couple of trips to Harrisburg. And by the time the thing is finished you don't know where you stand; that is, if you attend to it yourself. If you hire a lawyer to tend to it you might as well get rid of the estate, because after the lawyer's fee for settling it it would not be worth anything.

Senator BARKLEY. You must accept the definition of the Irishman who described a contingent fee, where if you lost your case your lawyer gets nothing, and if you win your case you get nothing?

Mr. FISHER. That is right. That is right, Senator Barkley.

Senator BARKLEY. Let me figure here with you. You have mentioned your estate. Now I do not want to go into the value.

Mr. FISHER. That is all right. This is a public hearing. It is \$180,000.

Senator BARKLEY. Under this bill assuming your estate is worth \$180,000, that that is the inheritance——

Mr. FISHER (interposing). Yes.

Senator BARKLEY (continuing). That you would get under any estate as being worth \$180,000, and what each one would get if the total estate was \$180,000 would depend upon how many children, how many heirs there are.

Mr. FISHER. Yes, sir.

Senator BARKLEY. Assuming you got \$180,000 as your share of an estate under this bill there would be \$15,600 tax on the value of it up to \$100,000.

Mr. FISHER. Yes, sir.

Senator BARKLEY. And for the excess there would be 24 percent; 24 times 80; that would be \$11,200, so that the total tax would be \$26,800.

Mr. FISHER. Yes, sir.

Senator BARKLEY. How do you figure that that would wipe out an estate of \$180,000?

Mr. FISHER. Why——

Senator BARKLEY (interposing). Wipe out the inheritance.

Mr. FISHER. As my wife is directly, according to this act, liable for the tax—I do not know whether the act means what it says—she would not have the money to pay it.

Senator BARKLEY. Suppose it is in real estate. Of course, if she did not have \$26,000 in cash to pay the tax she would have to raise it out of the estate. I mean if the estate were being sold, if she wanted to pay it at once, but under this bill she has or is given 8 or 10 years in which to raise that amount on the real estate if she wanted to hold it. Now, do you think that would wipe out her inheritance, or would she be embarrassed in raising that much money on \$180,000——

Mr. FISHER (interposing). I say it would be entirely impossible to do it.

Senator BARKLEY. Over a period of 8 or 10 years or 12 years. You might even have 12 years.

Mr. FISHER. You might just as well not leave an estate, because the complications extend over a 12-year period of time and so forth. I would like to explain. You have asked a very reasonable question, Senator Barkley, and I want to answer it.

Senator BARKLEY. I am trying to get the facts as to the estate which you mentioned, which is your own.

Mr. FISHER. Yes. Well, there are the taxes and maintenance to contend with in the meantime. And there is earnings of the property. Now, she would be in possession. Under this law these assessors from the Internal Revenue Department would fix the value of that estate at some value and as donee she would be liable to pay that tax. Now there is a case where you are not selling the property. You are transferring the property, which has a certain amount of income from renting the houses attached to it, but she is liable under this thing for that tax.

Senator BARKLEY. Yes; she is liable, of course.

Mr. FISHER. She is liable under that.

Senator BARKLEY. But there is a lien, probably a secondary lien.

Mr. FISHER. On the property on behalf of the Government? No; the property is practically clear.

Senator BARKLEY. I mean a tax itself operates as a lien. The property is clear and being rented, and if the tax were \$26,000 and she had 10 years in which to pay it it would be an average of \$2,600 a year. Would that operate as a great burden on the value of property worth \$180,000?

Mr. FISHER. Yes, sir. It absolutely could not be done.

Now even under those low taxes there after the settlement of the estate I had to borrow money to get through 1 year, and I will say my wife went to work for 5 months to help us out. For the next year, although I paid an income tax, I had to borrow \$400 from the bank.

I want to take up these questions of transmission, of why it is the desire of government to split the family. At the time of death when all have long illnesses and high expenses the Government steps in and soaks the family for no apparent purpose. I can give you another example. Even at the low State of Pennsylvania inheritance tax of a property not far from mine, a suburban property—and of course the assessors have got an idea there is a wonderful value to it, someone who owns it dies. Why, they can't any more pay the inheritance tax to the State of Pennsylvania than they can fly. They cannot sell the property or do anything with it. And no inheritance tax assessor will assess property for inheritance-tax purposes for less than its theoretical value.

Senator BARKLEY. Nobody who owns property would take less than the assessed value, would they, usually at a sale?

Mr. FISHER. At the present time property is being sold at one-tenth of the assessed value in many cases.

Senator BARKLEY. That is, distressed property; yes. Ordinarily people do not give in their property for full value. If the State or municipality gets two-thirds on the property for taxing purposes it is rather fortunate, is it not?

Mr. FISHER. Wait a minute. I don't quite get that question.

Senator BARKLEY. I say taking it at an average assessment, if the State gets an assessment for taxable purposes of two-thirds of the actual value of the property, it is pretty lucky. I have known many cases where the actual assessed value of property for taxation purposes was not half the value of the property on a sale. Of course, I am not talking about these distressed times; I am talking about in normal times when there is a sale for real estate, which we hope there will be in the very near future. I have had some experience in county government before I was demoted to Washington.

Mr. FISHER. I see.

Senator BARKLEY. My experience and observation has been that the assessed value of property as a rule all over the country is very much less than its actual value.

Mr. FISHER. Now, let us say its actual value, Senator Barkley, is based not on liquidation, but on a willing buyer and a willing seller value.

Senator BARKLEY. Yes.

Mr. FISHER. The theory of assessment and the Pennsylvania law says a property shall be assessed at its value at sale after due notice. That is liquidation value. That is quite a different thing from a willing buyer and a willing seller.

Senator BARKLEY. What is the inheritance tax rate in Pennsylvania?

Mr. FISHER. I think that telegram would indicate that it is 2 percent. I think it is going to be increased, if I am not mistaken.

Senator BARKLEY. How long has it been in force?

Mr. FISHER. A great many years. And it is uniform. It is just as much if you inherit \$100 or \$1,000,000.

Senator GORE. What was the point? I did not understand it.

Senator BARKLEY. I asked him the inheritance tax in Pennsylvania. He said it was 2 percent straight tax.

Mr. FISHER. You take another State that has not got an estate tax and an inheritance tax. I suppose there are some; I do not know. There are some States, I believe Senator Barkley said, that have reduced their real-estate tax to nothing. I think possibly Ohio and Indiana have.

Senator BARKLEY. That is for State purposes.

Mr. FISHER. Yes; but not for local purposes.

Senator BARKLEY. North Carolina has done the same.

Mr. FISHER. Yes. If you take in Pennsylvania 2 percent out of an estate and then you tax a Federal estate tax, and then on top of it an inheritance tax, why it seems to me that it is going to embarrass many hundred thousands of citizens in Pennsylvania.

I have here the Philadelphia Record of Tuesday. It reads:

In the case of four properties owned by the estate of James Elverson, Jr., at 2024 to 2030 Walnut Street, inclusive, there is \$50,000 due in taxes. A purchaser is willing to bid this amount, so I have ordered these properties placed on sale by the sheriff. The tax lien is the sole incumbrance on the property.

Now a person inheriting property like that I do not know where they would get off.

Here is a property here, the Penfield Building, valued at some \$3,000,000. The Penfield Building is a comparatively small office building. It might be compared to an apartment house. There are many apartment houses under one ownership, and they are all in distress in Philadelphia at the present time. If somebody inherited that Penfield Building, what value under this law would be placed on it? There is \$3,000,000 and it is not worth 5 percent, and it would probably be sold for taxes, and yet under this law the Internal Revenue Department would go and try to collect a tax from it. I do not see where it does not confiscate from practically every real-estate owner in Pennsylvania almost that owns anything, unless you just own your own home and have an income. If you own several properties which you have for rent, as I do, I have seven that I own and at the time of death these inheritance and estate taxes on the basis of that telegram which I showed you practically took the equivalent of 1 year's taxes, and you have got to pay 2 years' taxes in 1 year, that is your current real-estate tax, and in addition to that an equal sum in amount.

The CHAIRMAN. Was there anything else that you desired to tell the committee, Mr. Fisher? The committee is very thankful to you for bringing this practical situation here to us.

Mr. FISHER. Yes, sir; there are other things. I did want to speak of other important matters, but if the committee is fatigued and so forth, I will not. I came here on April 17, 1932, to be heard by the Senate Finance Committee when Senator Smoot was chairman, and I came here with the intention at that time of presenting these matters in regard to the effects of taxation on the income and earning of the people. Now I can put that in in the form of a short statement.

The CHAIRMAN. If you will get that up you can do so, but you ought to get it up right away and give it to the clerk, your statement on that.

Mr. FISHER. Yes.

The CHAIRMAN. And I want to say to all the other witnesses that if there are any corrections to make in their statements that they must be made immediately, because these hearings must be printed at once. So the committee will be very thankful to you, Mr. Fisher, if you will give that to the clerk.

Mr. FISHER. Thank you very much, Senator Harrison, for your attention.

(The following statement was subsequently submitted by Mr. Fisher:)

Due to the fact that the hour for the final closing of the hearing was reached during my verbal testimony, the committee extended me the courtesy of inserting the further statement which I do so as follows:

Continuing my verbal testimony as to the general statutes of the real-estate owner by citing as an example my own real-estate inheritance received in 1932 from my paternal parent: The earning power of these properties in common with other real estate is even now under careful management relatively small and is threatened to be extinguished at any time by encroachment of State or local taxes or other adverse circumstances connected with the depression, although location and freedom from incumbrance is unusually favorable compared to the run of real estate.

Because of the hazards of vacancies and other contingencies the owning of improved real estate usually involves the ownership of several properties. In this respect the profession of owning and managing real estate is not dissimilar to other industries and cannot be considered of concentration of wealth but is a business activity of value to the Nation. Inasmuch as about half of all housing in the United States is rented, the business of housing is one of the largest occupational employments and its maintenance the principal source of the so-called "durable goods" industry.

Investment in housing and loans on housing have been a very general and safe form of providing for old age and dependents and for loans by insurance companies savings banks, etc.

The narrow margin between rents and taxes has largely cut off not only the employment in the maintenance of housing, miscellaneous buildings, etc., but also employment in the secondary and collateral pursuits thereto. An employment void, affecting probably 5,000,000 persons, is thereby created in addition to loss of income to owners, who are virtually forced by Government to contribute their labor and savings to the housing of the Nation at either a loss or a nominal return. It is contended by the opponents of this act, that, if inherited real estate is clear of incumbrance, no serious difficulties other than liquidation over an extended period are presented to the recipient of an inheritance.

In the State of Pennsylvania, this would not be the case. The donee, if widow or child, would upon death of the provider be deprived of income for the reason that the normal earnings of real estate do not ordinarily admit for the paying off of death duties in appreciable amount. This is precluded by current maintenance and tax charges. Properties not receiving their regular maintenance quickly lose their regular value. The complications presented suggest that in many cases no income at all would be available. In the case of unimproved land, immediate liquidation by sale in those cases would be indicated. At the present time and probably for many years to come this kind of liquidation presents many difficulties especially in the case of a bill of this kind where three separate and distinct valuations are involved as follows: The Pennsylvania State tax, Federal State tax, and Federal inheritance tax. If the practices as to valuation for the inheritance tax law follow the present practices of the State tax valuation it is almost certain that the liquidation at sale after the notice would be so much below the willing buyer willing seller price, as to indicate the entire loss of the inheritance. It must be borne in mind that the double estate taxes call for a rather prompt settlement and must be gone through with first before the inheritance tax law applies.

At the present time the majority of real-estate properties, even though fully improved, either lack earnings enough to cover taxes, or, if so, the margin above is limited. Even though a portion of the inheritance should escape the estate

tax levies, it is doubtful that they could be continued in the ownership of the donee subject to a series of inheritance tax installments. A large number of cases at the present time listed in the daily papers of all kinds of properties large and small including hotels, office buildings, and central city property as well as suburban properties which are being sold or will be sold for taxes indicate the impossibility of imposed inheritance taxes to real estate.

The same applies to mortgage-holding inheritances, which, although the mortgagee may be willing to assist the mortgagor, must usually be foreclosed, because the State requires payment of its taxes on mortgages regardless of interest default. Mortgagees are, therefore, forced to foreclose or abandon to the sheriff as evidenced by 1,000 to 1,800 sheriff sales a month for the past 4 or 5 years in Philadelphia alone. This condition is very wide-spread.

In addition to the above cited difficulties placed on the citizen, the act may be further objected to on the ground of double burden in undetermined amounts of tax by two Federal taxes in addition to State tax, placing the individual in triple jeopardy and to triple cost as to both Government administration of the tax and private expenses and legal and other matters connected thereto and, therefore, is an act beyond the granted powers of the Constitution.

Passing now to a consideration of the effect on the Nation and the income which the citizens may enjoy either individually or collectively as a result of their labor in extracting, processing, and interchanging the substances of nature we find as follows:

THE EFFECT OF GOVERNMENT EXPENDITURE ON THE PEOPLE'S EARNING INCOME AND EMPLOYMENT

In an ascending scale of governmental expenditure a general distortion and local distortions are produced between Government activity work and the labor of producing, distributing, and interchanging maintenance. This operates to reduce the effective distributable income of the Nation and of its individuals. Due to the fluctuations in both the value of money and the value of various and sundry goods interchanged, the money value of the total national income and of the several individuals composing the Nation also fluctuates. In order to get a comparison from year to year and in order to ascertain the comparative income under different degrees of taxation, resort must be had to a reduction to terms of effective income money flow.

Making use of accepted statistics it is found that over the past 20 years, in each and every year successively, that the effective income, within a few percents, corresponded to the ratio between maintenance producing activities, together with the activities involved in their interchange and distribution, to the total of governmental activities throughout the Nation. When through maladjustment of wages, taxes, finance, etc., unemployment occurs, such operates to increase the Government activity ratio and to raise the tax rate by reducing the effective income.

Similarly, Government activity through borrowing raises the ratio of Government activity to self-supporting activity, reduces the effective income, and so raises the tax ratio in terms of dollar income.

Also, in a rising or risen scale of Government expenditure, there are tax inequalities developed within and between occupational divisions which further act to set up employment voids at those points, such as in the housing industry, where unreduced taxes meet and absorb the gross income and thus shut off the margin of funds for employment, wages, or profits.

Also, under an ascending or ascended scale of Government expenditure, when the accompanying contraction in effective spendable income encroaches on the family's major necessities, the contraction in purchase of minor necessities involves the secondary and collateral pursuits. Those dependent on this kind of employment are subject to reduction in number or wages, or both. An employment void is created which is not readily corrected by the extragovernmental activities being set up for its amelioration.

The general effect of the above conditions forces changes or migration of occupational employment to Government activity work or support, but these maladjustments are not readily corrected and prolong readjustment of employment.

The following table shows approximately the developed unemployment under an ascending scale of unadjusted Government increase as applied to the continental United States. It has been found below the 10-percent tax rate (which is the normal 50-year average on the national-income basis, but which actually represents a total diversion into Government activity and its support of 20 percent) that income has a tendency to increase faster than the growth of population

due to improved mechanization and management. The occupational employment of the Nation is therefore based on the 10-percent tax rate.

Tax rate	Computed unemployment (families)	Compare to year of—
10 percent.....	None	
12 percent.....	1, 064, 000	1929
16 percent.....	3, 124, 000	1930
22 percent.....	6, 044, 000	1931
31 percent.....	10, 000, 000	1932

Another effect of an ascending scale of Government increase is to reduce prices or cause them to break under the pressure of the lessened buying power of a contracted effective income. This results in a total lessened demand or interchange capacity for products of farm, factory, housing, office space, etc. This effect has been very pronounced in this depression and is not readily corrected.

In order to properly reverse the above conditions and to increase the effective distributed income of the Nation the Government activity ratio expense must be reduced by sacrifice on the part of those in Government work comparable to the sacrifice imposed to the general run of supporting activities in either individual or mass compensation.

In this way, closed employment channels are reopened as migration back to maintenance activities and interchange takes place with increase of effective income. The usual ratio of such recovery, or upward spiral, when relief is afforded either from governmental borrowing or taxation, is as 2 to 1 for each channel for reemployment reopened or for the Nation about \$1,000,000,000 a month instrument in employment. This was about the ratio of increment which took place in the post-war recovery upon cessation and easing of war borrowing and excess taxes.

The downward spiral in the post-war depression and in the 1929-33 depression was at a slightly faster rate than the recovery of 1921-22. The tendency of the downward spiral when the price level has once been broken is for prices to seek levels as much below world level prices as the tax rate is above world level taxes. The 1921-22 recovery checked the downward price spiral, however, but in this depression this condition necessitated the revaluation of our currency to prevent an abnormal disturbance in the price basis.

Upward and downward spirals may take place in opposite directions to the price trends as was shown in the post-war recovery when the upward spiral was well under way and checked the downward price spiral.

The assumption therefore is that under the existing ratio or Government activity to maintenance activity the effective income will remain for some time at a level perhaps 30 to 60 percent below normal effective incomes, except as better adjustment and employment is attained. This deficiency will remain until steps are taken by Federal, State, and local governing bodies to readjust the ratio of Government to so-called "private or maintenance activity."

As Mayor W. N. McNair, of Pittsburgh, pointed out in this hearing, the draining of income from localities to others, and to uses the benefit of which does not flow to all the people, a statement which applies more particularly to Federal taxation, is not a lawful tax operation to the full benefit of those taxed and, therefore, unconstitutional.

In the larger sense, considering taxes as a whole, a plenitude or excess of public services and works beyond their usefulness and facilitating effect on the maintenance activities of the people, creates a void in the production and distribution of effective income and operates against the general welfare if a reduction in the general standard of living of the people and the enjoyment by them of the minor necessities and tangible benefits produced by the secondary and collateral pursuits as a criterion.

It may be properly argued, therefore, that the attendant unemployment arising from an ascending or an ascended scale of Government expenditure and the loss in the standard of living to the people is not balanced by plenitude or excess of Government services or works.

The act therefore may be objected to and is objected to in its entirety as not in the public interest and against the general welfare clause of the Constitution where under the people have granted taxing powers to the Federal Government. The act is therefore unlawful as an invasion of the rights of the individual and the mass

to a reasonable percentage of the proceeds of their maintenance activities and their labor in that connection.

The taking by Government of a portion of the income of money flow by this tax measure from the established channels of disbursement whereunder people are now employed, and the handing over of this disburseable income to the support of the tax-supported and tax-exploiting activities of the Nation is merely maintaining or increasing the ratio of Government activity and is desired largely by the persons now engaged in governmental activity as they do not wish to be returned to self-support. The estimated employment migration or unemployment void created by additional tax revenue of the amount contemplated may be estimated at about 300,000 persons. It does not appear to be in the public interest to create a further employment migration at this time or to suffer that many persons to be thrown on relief as the case may be.

Under the income taxing powers, granted by an amendment to the constitution, the power is only granted to tax income in the sense of income in the possession of the individual which is of a spendable nature. There appears to be no power granted in the Constitution for the Federal Government to attach and sell property of individuals other than money property. The act is therefore is as unconstitutional as well as the existing legislation which it is intended to supplement.

The CHAIRMAN. I desire to have inserted in the record a letter and statement by Mrs. Edith Nourse Rogers, Representative in Congress from the State of Massachusetts, with reference to the pending Revenue Act of 1935.

(The matter referred to follows:)

HOUSE OF REPRESENTATIVES,
Washington, D. C., August 8, 1935.

HON. PAT HARRISON,
Chairman Senate Finance Committee,
United States Senate, Washington, D. C.

MY DEAR SENATOR HARRISON: I am enclosing two statements concerning the tax on insurance, which is embodied in the revenue bill, now pending. I have talked with the Legislative Counsel, Mr. Parker, and others and find that I am correct in my ideas on the matter.

May I urge most strongly that this feature of the measure be rectified, and that action on the bill be deferred until the next session of Congress.

It is very evident that the haste in preparing the bill is responsible for the glaring injustice done every holder of an insurance policy.

With my best wishes and kindest regards, I am,

Very sincerely yours,

EDITH NOURSE ROGERS.
(Mrs. John Jacob Rogers.)

PROTEST MADE TO HON. EDITH NOURSE ROGERS BY FEDERAL INSURANCE GROUP CONFERENCE

Statement covering a situation which will prevent the necessary immediate or early payment of proceeds of insurance policies which are intended for the payment of funeral expenses, etc., that will result from the passage of the Revenue Act of 1935 title to covering inheritance taxes.

Under the provisions of this act, section 203 (a) (7) the proceeds of insurance policies are made taxable transfers. There is no credit whatever with respect to insurance and while there is a specific exemption to each beneficiary of \$10,000 there are many instances where the beneficiaries insurance proceeds may compose part of a sum that exceeds \$10,000. While in many instances the final action will disclose that there will be no inheritance tax with respect to beneficiaries, there is an administrative provision in the law which it appears will either preclude the payments or make it very difficult to pay such proceeds. The provision in question is contained in section 211, which reads in part: "The tax imposed by this title shall be a lien upon the property with respect to which the tax is imposed for fourteen years from the date of the death of the decedent; except that such part of the property as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien. * * *

Under the aforesaid provision there is a statutory lien against the proceeds of an insurance policy and this can only be reduced or eliminated by a court having

jurisdiction which in most cases will take months and sometimes years. The Government Group Conference, which consists of associations in Government departments which were organized especially for the purpose of taking care of burial expenses and so forth at the immediate time of death and total membership is nearly 100,000 Government employees, it appears that the provisions of the aforesaid act if enacted into law will very much hinder the object intended by these associations, it also appears that the act would be applicable to insurance policies issued by the Veterans' Administration and to the various and many fraternal beneficial associations throughout the United States as well as insurance companies.

It probably will affect a great percentage of the entire population of the United States, most likely including Members of the House and Senate themselves.

THE REVENUE ACT OF 1935

EXTENSION OF REMARKS OF HON. EDITH NOURSE ROGERS OF MASSACHUSETTS IN
THE HOUSE OF REPRESENTATIVES, SATURDAY, AUGUST 3, 1935

Mrs. ROGERS of Massachusetts. Mr. Speaker, daily the women of the country are becoming more alarmed over the high cost of food and clothing. They are becoming more and more active, and are protesting the measures which will take away their security. They are protesting against the added future in security of the ill-considered and hastily drawn tax bill, which they realize will work such an injustice to them and to their children. One of the worst features in the bill is the tax on insurance, and they are praying for delay. As Calvin Coolidge once said, in effect: "If the women want a thing, and insist upon it, they will get it."

The inheritance tax in this bill subjects all insurance to taxation, regardless of the amount. The present estate tax exempts all insurance amounting to less than \$40,000 from any taxation. But the worst feature of the administration's proposal is that the insurance companies will not be able to pay any insurance to the beneficiaries immediately upon death. In many families insurance is carried in part to provide burial expenses, but even in such a case the insurance companies will be required to withhold payment, no matter how small the amount, until the amount of the tax due from the beneficiary is determined, or else assume personal liability for the tax. This means that thousands of widows and other dependents who have counted on insurance being available to them at death will have to wait many months. Anyone knows that the legal delays involved in settling even small estates require months, and even years. The great popularity of insurance has been largely because it is paid immediately and carries the family living expenses while the estate is being settled. Delayed payment will cause real distress and will place more on relief, for they will not be able to borrow from the banks. No bank will loan until it finds the amount of the tax.

This is but one example and one result of the lack of careful and complete study which a bill for revenue must have in order to be just. To enact so vital a piece of legislation in the closing days of a session of Congress means that many must suffer through carelessness and lack of consideration. In this particular instance it is the widows and dependents. They are the ones who should be most protected.

STATEMENT OF HON. EDITH NOURSE ROGERS

The women are greatly frightened at another feature of the bill which shows the necessity for careful study, and which argues for delay in passing such a measure. It also affects women and dependents, as does the proposed tax on insurance. This is subsection 6 of paragraph A of section 203, found on page 18. Frequently on the purchase of real estate or the opening of a savings account, it is put in the joint name of husband and wife in such form that at the death of either it goes to the other automatically and without going through the courts or the laws relating to estates. The money in most cases with which the account is built up or the real estate bought, comes from the earnings or other income of the husband, plus the savings of the wife from money given her by the husband.

Under the language of the section above referred to, the wife would have in such a case to prove either that the money was originally her own or that she gave the husband "full and adequate consideration in money or money's worth." To put a widow to the proof that her housekeeping, her thrift, and her other services to her husband constituted an "adequate consideration in money's worth" would be intolerable.

Securities are sometimes similarly purchased and put in the joint name with right of survivorship, but this is less frequent than real estate and savings accounts.

This whole section should be changed radically. Of course, as to savings accounts in joint names, the bank would be in the same position of inability to pay the survivor without taking liability for the tax until the estate was settled and the tax paid, and therefore the cash funds carried in the joint name for emergency use would be unavailable in the time of greatest need.

Senator WALSH. Mr. Chairman, I ask to have printed in the record of these hearings certain memoranda with reference to the estate and inheritance provisions of the pending bill.

MEMORANDUM WITH REFERENCE TO THE ESTATE AND INHERITANCE PROVISIONS

It is assumed that the House, in adopting the schedule of inheritance taxes, believed that the dollar balances left in an estate after payment of expenses and taxes would actually exist and would accrue in the amount of such balance to the beneficiaries. That on net estate of \$500,000 for instance, the balance after taxes of \$337,000, and on \$1,000,000 a balance of \$581,000 would exist and be received by the beneficiaries.

This would happen but in few instances. In perhaps a majority of estates there is real estate, interests in business, stock in a close or family corporation, securities not readily salable, family homes, mortgages, and a variety of properties, all making up a value upon which taxes must be paid, but not readily salable, and if salable at all, only at a serious sacrifice. Wherever the balance of appraised value after taxes and expenses consists of such slow assets there is almost certain to be a serious shrinkage in that balance, and but little, if anything, actually realized for beneficiaries.

The examples attached as exhibits are actual estates, lately administered, showing character of assets, appraised value, amount of Federal and State estate taxes, proposed inheritance taxes, cost of administration, the balance apparently left to the beneficiaries, and of what that balance would consist.

The first example is an estate of about \$350,000, consisting of real estate of \$50,000, and the entire stock of a cotton mill appraised at \$300,000. Expenses and taxes would have been approximately \$100,000. No such sum could have been raised except by sacrifice sale at around \$200,000. The family would have lost the mill, and had, at best, probably less than \$100,000 from the sale of the mill, and the real estate which they could not have afforded to keep.

Second example: Estate appraised at \$2,000,000; real estate, \$377,000; stocks, bonds, and cash, \$203,000; real-estate mortgages, \$1,540,000. Administration expenses and debts, \$200,000; present estate and proposed inheritance taxes, \$815,000; total cash required for taxes and expenses, \$1,015,000. This would leave a theoretical balance of \$1,100,000 to the family, but to have raised cash for taxes and expenses would have exhausted the entire cash, stocks, and bonds of \$203,000, and required \$800,000 from real estate and real-estate mortgages. At no time since the death of the decedent could \$800,000 have been realized from the mortgages and real estate without practically exhausting the entire estate.

Third example: Appraised value, \$4,317,000; real estate, \$764,000; stocks and bonds, \$563,000; cash, \$140,000; stock, family-owned corporation, \$2,770,000. Deductions, administration expenses, and debts, \$621,000; estate taxes, \$1,282,000; inheritance taxes, \$1,001,000; total cash for taxes and expenses required, \$2,905,000, leaving a theoretical balance of \$1,400,000 for beneficiaries. It would have required all of stocks, bonds, and cash of \$703,000, leaving \$2,202,000 to be realized from stock of private corporation and real estate for taxes and expenses. It would have been impossible to realize \$2,900,000 for taxes and \$621,000 for expenses and debts without practically exhausting the entire estate. Probabilities are there would have been a deficit if forced sale had been required.

Fourth example: Estate appraised at \$13,000,000; net estate after debts and expenses, \$11,800,000; estate taxes, \$5,827,000; inheritance taxes, \$3,115,400; expenses, \$1,497,000; and balance of \$2,800,000 for beneficiaries. Estate consisted of real estate in New York and California, important manufacturing enterprises in Pennsylvania, interests in oil wells and oil properties, and in extensive real-estate development company. There was no possibility then or now by which \$8,900,000 for taxes and \$1,497,000 for debts and expenses could have been raised. The entire estate, if sold at any time since death, would not have

realized such sum in cash. There would have been nothing left for beneficiaries. After payment of relatively small taxes, the estate is now being slowly liquidated with promise of considerable residue to 45 beneficiaries.

The proposed extension to 10 years of time for winding up estates affords no relief, except in few cases. Executors and the legatees are made liable for the entire amount of the tax assessed, regardless of whether or not the estate finally produces that amount. No executor, and but very few legatees, would be willing or could afford on such small margin to take the chances of holding investments or operating properties or businesses over a long period of time at the personal risk of the executor and legatee for balance of taxes and the heavy interest beyond what is realized from the estate. The executor is also accountable to the courts for holding property under such extensions. If the property were held for a number of years and loss ensued, the courts might hold the executors liable for such losses as an imprudent venture. Nor in such cases could the executor pay any income to the widow or any beneficiary during period of such extension; the family might be penniless for years. Only where an executor can sell and realize sufficient cash within 1 year from the date of the owner's death to pay taxes and expenses could it afford to qualify in any of these cases with slow assets.

Attached is a memorandum prepared by M. P. Callaway, of the Guaranty Trust Co. of New York, and one by Robert M. Hanes, president Wachovia Bank & Trust Co., of Winston-Salem, N. C., containing these examples referred to and a few others, with a more complete explanation of each case, demonstrating in estates with some slow assets the disastrous results to the beneficiary after the payment of State and Federal taxes and the proposed inheritance tax. Also illustrating the impracticability of selling bonds or borrowing money for such tax purposes, and of any executor or legatee, in most cases, using the provisions for the 10-year extension of time to liquidate estates.

NO. 1 (P. 5 OF MEMORANDUM)

Estate, \$350,000; deceased 1928.

Quick assets: None.

Slow assets:

Residence, farm, and business property	\$50, 000
Cotton mill	300, 000
Total	<u>350, 000</u>

Deductions:

Administration expenses, executors and attorneys' fees, and debts	17, 000
Federal and State estate tax	38, 880
Proposed inheritance tax	43, 718

To be realized from slow assets	99, 598
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The amount of \$99,598 could not have been raised or borrowed. Property would necessarily have been sold at sacrifice with loss of the mill to the family.

NO. 2 (P. 4 OF MEMORANDUM)

Estate, \$2,129,000; deceased, 1930.

Quick assets:

Stocks and bonds	\$130, 000
Cash	73, 000
Miscellaneous	5, 000
Total	<u>208, 000</u>

Slow assets:

Real estate	377, 000
Mortgages	1, 544, 000
Total	<u>1, 921, 000</u>

Deductions:

Administration expenses, executors' and attorneys' fees, and debts	\$200, 000
Federal estate tax and New York estate tax	463, 412
Proposed inheritance tax	352, 380
Total	1, 015, 792
Less quick assets	208, 000

To be realized from slow assets 807, 792

To raise \$1,015,792 for taxes and expenses would require all the cash and securities of \$203,000 and \$800,000 from mortgages and real estate. At no time since the death of the decedent in 1930 could this have been done except by practically using the entire estate.

NO. 3 (P. 5 OF MEMORANDUM)

Estate, \$4,317,000; deceased, 1931.

Quick assets:

Stocks and bonds	\$563, 000
Cash	140, 000
Miscellaneous property	5, 000
Total	708, 000

Slow assets:

Real estate	764, 000
Close corporation stock	2, 771, 000
Mortgages	15, 000
Total	3, 550, 000

Deductions:

Administration expenses, executors' and attorneys' fees, and debts	621, 000
Federal estate tax and New York estate tax	1, 282, 826
Proposed inheritance tax	1, 001, 250
Total	2, 905, 076
Cash legacies	10, 000
Total	2, 915, 076
Less quick assets	708, 000

To be realized from slow assets 2, 207, 076

After using cash and securities of \$708,000, the balance of \$2,207,000 could not have been raised. At a forced sale the probabilities are that not enough would have been realized to pay taxes and expenses. The estate taxes actually paid in this estate (\$363,046.79) would now amount to \$1,282,826, not including any inheritance tax.

NO. 4 (P. 8 OF MEMORANDUM)

Estate, \$13,330,000; deceased, 1928.

Quick assets:

Cash	\$631, 000
Stocks and bonds	745, 000
Total	1, 376, 000

Slow assets:	
Real estate.....	5, 084, 000
Tangible property.....	165, 000
Notes, mortgages, loans.....	3, 260, 000
Stocks.....	3, 200, 000
Leaseholds.....	85, 000
Partnership interests.....	160, 000
Total.....	<u>11, 954, 000</u>
Deductions:	
Funeral expenses and debts.....	1, 497, 000
Federal estate tax now imposed.....	4, 126, 302
New York estate tax now imposed.....	1, 701, 100
Proposed inheritance tax.....	3, 115, 406
	<u>10, 439, 808</u>
Quick assets.....	1, 376, 000
To be realized from slow assets.....	9, 063, 808

NOTE.—Executors and trustees have been endeavoring to sell many of the slow assets for several years and those so far sold have been at a price far below their appraised value for taxes. If slow assets held today were sold, the proceeds, together with the amount realized on slow assets previously sold, could not possibly equal the tax liability of approximately \$9,000,000.

We would have been unwilling to have undertaken the administration of this estate had the proposed inheritance-tax law been in existence.

PAGES 5 AND 6 OF MEMORANDUM

Estate, \$1,486,465; deceased, 1928.

Quick assets:	
Stocks and bonds.....	\$419, 116
Cash.....	94, 264
Total.....	<u>513, 380</u>
Slow assets:	
Real estate.....	20, 000
Stock of close corporation.....	909, 250
Mortgages.....	1, 012
Total.....	<u>930, 262</u>
Deductions:	
Administration expenses, executors' and attorneys' fees, and debts.....	140, 914
Federal estate and New York estate taxes.....	281, 097
Proposed inheritance tax.....	159, 984
Total.....	<u>581, 995</u>
Less quick assets.....	<u>513, 380</u>
To be realized from slow assets.....	78, 615

After using cash and securities of \$513,380, there is nothing left but the family corporation, valued at approximately \$900,000. The taxes actually paid in this estate were \$87,000, the present Federal estate and proposed inheritance tax would be approximately \$341,000. Except for the unusual amount of cash and salable securities, the present and proposed taxes must have come from family business.

PAGES 6 AND 7 OF MEMORANDUM

Estate, \$1,721,000; deceased, 1934.

Quick assets:

Stocks and bonds	\$515, 000
Cash and insurance	377, 000
Payment on firm interest	170, 000
Miscellaneous	10, 000

Total	1, 072, 000
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Slow assets:

Mortgages	3, 000
Real estate	50, 000
Firm interest after cash payment	596, 000

Total	649, 000
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Deductions:

Administration expenses, etc	201, 000
Federal estate and New York State taxes	330, 420
Proposed inheritance tax	205, 464
Legacies, mostly to charities	295, 000

Cash to be realized	1, 031, 884
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To pay expenses, taxes, and legacies of \$1,031,884 requires all of the cash and investments and approximately \$150,000 out of the interest in the firm. Balance \$650,000, all in interest in the firm payable over a period of years.

PAGE 10 OF MEMORANDUM

Estate, \$144,198.49.

Quick assets:

Stocks and bonds	\$3, 706. 00
Cash	2, 029. 92
Miscellaneous	37. 57

Total	5, 763. 49
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Slow assets:

Stock of close corporation	122, 500. 00
Real estate	15, 000. 00
Tangibles	925. 00

Total	138, 425. 00
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Insurance payable to widow	27, 430. 99
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Deductions:

Administration expenses, executor's and attorney's fees, and debts	17, 731. 73
Federal estate and New York estate taxes	4, 335. 00
Proposed inheritance tax	10, 026. 00

Total	32, 092. 73
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Less quick assets	5, 763. 49
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To be realized from slow assets	26, 329. 24
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Cash requirements approximately \$32,000; cash assets, \$5,700; balance of approximately \$25,000 forced to be realized from stock of close corporation. Majority stockholders have refused to make reasonable offer. No way to raise money for what majority stockholders will pay.

STATEMENT OF M. P. CALLAWAY

No one would be justified in assuming that, in fixing estate and inheritance taxes, it would be the purpose of Congress to make these combined taxes so high that the results would practically be confiscation of entire estates, or that a reasonable balance should not be left out of estates to take care of dependents, consisting so often of the aged, infants, children to be educated, and those beyond self-support. To assume otherwise would mean that it is the intention to break up estates entirely, deprive widows and children of any inheritance, throw thousands of employees and servants out of employment, besides making tremendous inroads upon future income taxes to the Government.

It must be assumed therefore that the House, when adopting a tax schedule, believes that when this schedule is applied to the appraised value of any estate, the dollar balances shown in the estate over and above taxes will accrue in such amounts to the beneficiaries.

For instance, when on a net estate of \$500,000, the balance after taxes is \$337,968; on an estate of \$1,000,000 the balance is \$581,480; on \$2,000,000 a balance of \$977,792; and on \$10,000,000 a balance of \$2,684,492, Congress assumes that these balances actually exist and will go in those amounts to the beneficiary. In actual experience, however, this will not often be the result. The actual result in a very large percentage of cases will be that practically nothing will remain for the beneficiaries. This is due to the fact that in perhaps a majority of all estates there are interests in businesses; stock ownership in close corporations; holdings of securities not readily salable; city and country real estate; farms, lands, and homes; mortgages; and the variety of properties acquired by the average man, all entering into the appraised value of the average estate, upon the value of which the taxes are assessed.

Such assets cannot be sold, as a general thing, to raise large sums for taxes or any other purpose without considerable sacrifice, and all of such sacrifice and shrinkage comes out of this theoretical balance which it seems to be assumed will go to the beneficiaries. To enable an estate of any size to pay the present estate taxes (which have themselves been greatly increased during the past 4 years) and the proposed inheritance taxes, and to have the beneficiaries receive this apparent difference between the taxes and the appraised value, it would be necessary that the entire estate be in cash or in a character of securities that would be readily salable at not less than appraised value. This does happen in a few instances, but very rarely. In my experience as a trust officer for over 16 years, with a large volume of business handled yearly, I have known but very few cases where the entire estate consisted of cash and salable stocks and bonds from which could be realized for the heirs the balances they are assumed to get. Even in such cases, if the estate and inheritance taxes accrue at the beginning, or during a period of a falling market, such balance between the appraised value of the estate and the amount that must be paid for estate and inheritance taxes is likely to be wiped out in whole or in great part.

It is true, of course, that a large number of estates in this country consist almost entirely of securities; but very few of such estates consist entirely of high-grade, readily salable securities. Most of them contain a large percentage of securities difficult to market, and upon which losses under appraisal are bound to occur in their sale. So, that it is absolutely incorrect to infer or assume, even in estates consisting entirely of securities, that the apparent difference in dollars between taxes and the appraised value will accrue to beneficiaries. A majority, undoubtedly, of all estates in this country consists largely of what might be called slow assets. Great difficulty is now had by executors in raising sufficient cash to pay the existing Federal and State estate taxes (which taxes have been so tremendously increased within the past 3 or 4 years) and it seems certain that to add an inheritance tax that, generally speaking, will almost double the present cash necessities for estate taxes, will make it almost impossible to settle estates and pay these taxes without jeopardizing whatever might be left after taxes, leaving the families practically nothing, or but little.

I have taken several estates that have been handled by us during recent years, in order to show about what makes up many estates. To these figures existing estate taxes, both Federal and State, and the proposed inheritance taxes, are applied, together with the cost of administration, to show the balance theoretically left to the beneficiaries, and of what these balances actually consist, as well as the possibilities or impossibilities of raising moneys for the existing increased estate taxes and the proposed inheritance taxes.

In the average estate, as well as in the case of estates consisting entirely of securities, if the owner happens to die during the period of a falling market, the final result is apt to be very serious to the beneficiaries. If the depression of the

past few years had been the only depression that we ever had or ever expected to have, illustrations of losses on falling markets would probably not be of much value, but the fact is, that throughout the history of this country, we have had many depressions, when securities and property reached very low prices, and these depressed periods will undoubtedly occur in the future.

As illustrating the shrinkage that will occur in times of a falling market, take the case we had of a man who died in 1929, before the break in the market, with an estate appraised for taxes at \$3,270,500, of which \$3,115,800 was in securities. Had all the securities retained their original appraised value, there would have been a balance for distribution of \$1,187,800, after payment of estate and proposed inheritance taxes and expense of administration; but these securities did not retain their appraised value. Over a period of about 2 years, in winding up this estate, there was a shrinkage of \$1,295,000, about 40 percent in value of these securities. It is true that in the House bill the extent to which the depreciation took place in the first year after the death of this man would have been considered in arriving at the value of the estate for tax purposes, and to some extent would have lessened the taxes, but to whatever extent the depreciation took place after the first 12 months, the loss would have fallen on the beneficiaries, so that under present and proposed taxes practically nothing would have been left for the heirs in this estate. In practically all estates arising during 1928 to 1934, inclusive, there were serious shrinkages, almost irrespective of what the estate consisted. But the wiping out of any balance to the family after payment of existing estate and proposed inheritance taxes does not depend upon there being a falling market. It depends upon the character of property left in the estate after payment of taxes, and the possibility of raising money to pay taxes. Falling and depressed markets but aggravate the situation.

Take a case where the estate consists largely of real estate and mortgages, besides stocks and bonds. The decedent left an estate of slightly over \$2,000,000, consisting of real estate appraised at \$377,000, stocks, bonds and cash of \$203,000, and real estate mortgages, \$1,540,000. Administration expenses and debts amounted to \$200,000. The present estate and proposed inheritance taxes would have amounted to \$815,000, requiring a total of \$1,015,000 in cash for taxes and expenses. This would have absorbed not only the cash, stocks and bonds amounting to \$203,000, but would have required \$800,000 to be realized from real estate and real-estate mortgages. To have raised at any time within the past 3 years \$800,000 out of real-estate mortgages and real estate in New York would have probably exhausted the entire balance of the estate, or at best at a tremendous sacrifice, as there has been practically no market for such mortgages, and but little for real estate. So it would have been necessary to sell the real estate for whatever it would bring, and sell mortgages at a fearful sacrifice. It probably would have been necessary to resort to public auction to dispose of the mortgages and real estate. Obviously this supposed balance of \$1,100,000 to this family, after the deduction of estate and inheritance taxes, would have been largely or completely wiped out. This estate had \$203,000 of securities and cash, and yet would have been wiped out under the necessity of raising and paying out over \$1,000,000 in taxes and expenses.

An estate consisting of real estate and mortgages is not an unusual one. Many estates throughout the entire United States consist very largely of real estate, and real-estate mortgages. We have had a number of them ourselves.

Another illustration of an estate handled by us where the estate consisted of real estate, stocks, and bonds, but with the stock of an industrial corporation owned by the family. The estate was comparatively a large one, appraised at \$4,317,000, but it was well diversified in that real-estate holdings were \$764,000; stocks and bonds, \$563,000; cash, \$140,000; and the stock of this closely owned corporation, \$2,770,000. The administration expenses and debts aggregated \$621,000. The estate taxes at that time—1931—were \$363,048, but the present estate taxes would be \$1,282,826, nearly three and one-half times as much in 1935 as in 1931. The proposed inheritance taxes would have amounted to \$1,001,250, requiring cash for taxes and expenses of \$2,905,000 to be raised in this estate. It would have absorbed all of the stocks and bonds of \$563,000 and the cash of \$140,000, leaving \$2,202,000 to be realized from the stock of this private corporation and the real estate. The real estate continued to decline and could have only been sold at a great sacrifice. So that to have raised this additional \$1,000,000 for inheritance taxes, not to mention the increase in the estate tax of over \$900,000, would have been an impossibility. It may be that the real estate and stock appraised at \$3,400,000 might have been sold for enough to pay these additional taxes of over \$1,900,000 with nothing left to the family,

but my own judgment is, there would have been a deficit, if there had been a forced sale. As it was, with the estate taxes one-third of what they are now and no inheritance tax, the family was able to carry on the business, affording work for many employees and saving a competence for the family out of this business built up by the father.

Take another illustration of an estate where there was a large amount of stocks and bonds; the biggest asset being the stock of an industrial corporation, built up by the decedent. The estate was appraised in round figures at \$1,400,000; stocks and bonds and cash \$500,000; stock of the close corporation at \$900,000. Administration expenses and debts amounted to approximately \$140,000. The present estate tax and proposed inheritance tax would have been \$441,000, leaving this theoretical balance of approximately \$900,000 for distribution. The taxes and the debts and expenses would have absorbed all of the cash and stocks and bonds of \$500,000, assuming that the stocks and bonds would have been sold for the appraised value. The balance left to the family of eight for distribution could only have been the stock of this manufacturing enterprise, appraised at \$900,000, with no outside cash or resources whatever. Attention might be called to the fact that this was one of the principal industries in the small town where it was located, and the heirs, after payment of the very much less taxes which applied at that time, carried on this business. It is very doubtful if it could have been done had the present estate and inheritance taxes been applied, and the family estate would have been seriously hurt. Had it not been for the unusually large amount of cash and salable securities in the estate, the balance of taxes would have necessarily come from the stock of the family corporation, thus forcing its sale or liquidation. This would undoubtedly have been at a severe loss. There are many estates where almost the entire estate is in some family enterprise like this, but with no large amount of cash or securities on the outside. Where such is the case these taxes must come from the business, whatever the sacrifice.

Another illustration of a considerable estate where the principal interest is in the business of decedent's firm is illuminating. Decedent owned stocks, bonds, and cash of \$895,000 and real estate \$50,000. His interest in his firm's business was appraised at slightly over \$750,000. The total estate, \$1,700,000. Administration expenses, debts, attorneys' fees, were \$201,000; Federal and State taxes on present schedules would be \$350,000 and proposed inheritance taxes \$205,000. Total cash requirements would be \$750,000, leaving for distribution \$950,000. There were legacies largely to charities of \$295,000, leaving a residuary estate of \$650,000. The requirements for debts, expenses, and taxes would have absorbed all of the stocks and bonds, and the cash except about \$140,000. After payment of legacies there would have been only \$650,000 left, requiring \$150,000 to be raised out of the interest in his firm and real estate. The value of the entire residue of the estate, consisting of an interest in his firm, which under the terms of the partnership agreement to be paid off in a period of years, would depend largely upon the ability of the firm to continue to earn and to pay. The interest in the firm could not be sold, and there would be no way for this estate to raise money out of the firm interest outside of the terms of the contract. If the firm for any reason should go out of business there would be but little for the family.

There are two important conclusions to be reached from this example: One is, that even in an estate as large as \$1,700,000, with practically \$900,000 in stocks and bonds, the only asset left to the family after taxes would be a part of his interest in the firm's business, subject to all the risks of a business. Few men who could foresee and figure out that out of an estate of \$1,700,000 the only assets after taxes left to his family would be an interest in his firm's business, valued at \$650,000 and payable over a period of years would have left anything to charity. It should be borne in mind that a new gift tax to be paid by the recipient is also proposed. It is equal to three-fourths of the inheritance tax, and is, in addition to the present gift tax, to be paid by the donor. The aggregate of these two gift taxes is so large as to present to any man desiring to turn his business over to his sons practically the same difficulties as his executor will find in raising money, and with the certainty confronting him that little will be left his family after higher tax, it seems beyond doubt that legacies or gifts to charity, colleges, and public institutions will largely disappear.

It has been our experience that it is in the moderate-sized estates that miscellaneous legacies to charities of all kinds, such as hospitals, orphanages, homes for the aged, aid societies, and to churches and colleges, are made. The very wealthy in this country are usually generous toward charities and public institutions, but in the past, being able to leave their money in large amounts, it was

frequently left to foundations established by them or to be established, or for some specific purpose, whereas the less wealthy usually left something to the charities that they have been aiding during the lifetime and to others which they desired to help, and if, upon the largely increased estate taxes, there is now added an inheritance tax of almost as great an amount, it seems absolutely conclusive that legacies and gifts for charities, colleges, and the like must necessarily be very much diminished, or left out altogether, in order to have something left for the families.

Take a large estate now being handled by us as another example. In 1928 this estate was inventoried at \$13,000,000. Debts and expenses of \$1,900,000 left approximately \$11,800,000. This estate, however, consisted of a variety of investments, as so many of those large estates do. Decedent owned real estate in New York and California; an important manufacturing enterprise in Pennsylvania; interests in oil wells and oil properties throughout the West; interest in an extensive real estate development company. He was active in business and a great money maker; employed many people, and had many varied interests. He used his money in his various enterprises, and left but a relatively small amount of cash and marketable securities. Had the present estate taxes and the proposed inheritance taxes been applied, there would have been left out of this net taxable estate of \$11,800,000 a balance on inventory dollar values of approximately \$2,800,000. Cash for estate taxes of \$5,800,000, and the proposed inheritance taxes of \$3,100,000 would have been necessary. There was no possible way then or now by which \$8,900,000 for taxes could have been raised. All of the real estate manufacturing enterprises, all of his interest in oil wells, if sold at any time after his death up to the present time could not possibly have realized \$9,000,000 cash, but after the payment of the much lower estate taxes required at that time, this estate is being gradually and slowly liquidated with good promise of considerable residue to some 45 beneficiaries named under the will.

There are many large estates fairly comparable to this one. There are, of course, large estates that do consist principally of securities, that could raise large sums for these taxes, but they are not so numerous. There are, perhaps, almost as many large estates that consist principally of real estate, or investments in family enterprises, and such cannot raise these taxes except by exhausting the holdings or seriously impairing the family business.

It is not, however, only large estates that will be seriously affected by the proposed inheritance taxes. There are thousands of potential estates throughout the United States where the bulk of the estate will consist of stock in a local close corporation wholly owned or owned in large part. In almost every community of the industrial States, and in many communities of the agricultural States, there is some local enterprise owned by one or more families, valued at several hundred thousand dollars, and of great value to the community. These would suffer almost as much as the larger ones of which examples are given.

I can give one instance in my own family. The estate consisted of a residence, farm and business property valued at about \$50,000, and the ownership of the entire stock of a cotton mill valued at about \$300,000. Administration expenses were about \$17,000 and the present estate and inheritance taxes would have amounted to \$90,000. The amount of cash necessary to be raised would have been approximately \$105,000. I do not know how any such amount of cash could have been raised. Bonds could not have been sold for that amount, even if it were legal to turn the proceeds of the bonds over to the estate. A bank loan certainly could not have been effected for that amount. It would have been necessary to have sold the mill at practically forced sale in order to liquidate, and not more than \$200,000 could have been obtained. After several years, due to the death of the son who operated it, the mill was sold on time for \$250,000, so that ultimately the family would have received about \$190,000 out of this \$350,000 estate, had the present and proposed taxes been paid. But a forced sale, which would almost have been absolutely necessary under the proposed laws, would have brought considerably less than the amount received, and would have forced the family out of the management.

This illustration will cover thousands of cases throughout the United States, where a local industrial enterprise, cotton mill, sawmill, or factory of some kind is owned by a family or a few stockholders. To force its sale for tax purposes might not necessarily discontinue its operation by some purchaser, but it would put the family out of management, and would largely deprive the family of the results of the efforts of years of the owner to provide for his family.

Where the estate consists of a part of the stock of a corporation of the character above set forth, the situation of the family in raising money for the estate and inheritance taxes is almost hopeless. In the case I have stated, two heirs owned

the property, and were able to sell the mill and liquidate the whole company, whereas if the stock had only been that of a part ownership and the other stockholders desired to continue the operation of the company, the estate would have been practically at the mercy of the others for the price to be paid for their holdings.

To illustrate:

An estate consisted of real estate, \$15,000; stocks, bonds and cash, \$5,000; and minority stock in a close corporation valued at \$122,000, the aggregate estate being approximately \$140,000. Administration expenses were approximately \$17,000 and the proposed taxes \$14,000. The cash requirements, therefore, for taxes and expenses would be approximately \$30,000, while the quick assets were approximately \$5,000. It would have been necessary therefore to provide the remainder of necessary cash by the sale of the stock in the corporation. No offer has yet been received that is considered anywhere near appraised value, but fortunately does not have to be sacrificed, there being sufficient funds to pay taxes at the existing rates. Otherwise, the stock would have to be sold for what the majority stockholders would pay for it.

With respect to all of the above cases, which represent a tremendous number of similar cases throughout the country, the act proposes a period of grace of 1 year from the date of death in arriving at the inventory value for taxation and, in the discretion of the Commissioner, 10 years from the date of the death until the final payment of the taxes on the basis of the appraisal at the end of the first year, or at whatever time the tax assessment is made.

This period of 1 year of grace will be helpful. The provision for a leeway of 10 years in practical effect is not only worthless, but is liable to lead an unwary executor into serious trouble. The act provides that the executors shall be liable for the tax required to be collected, whether or not the estate produces it. The legatee is also made liable personally for the payment of the assessed tax, irrespective of the final result of the estate. At best, any holding of securities or properties for sale at a future date through a period of years is very uncertain. This is recognized in the act itself, which provides that the tax authorities may require a bond payable in double the amount of the tax assessment, besides holding both the executor and the legatee personally liable for the tax. No executor and, in most cases, no legatee, would be willing, or could afford to take the chances of holding investments or operating properties or businesses over a long period of time with all of the risk assumed by the executor and legatee, and at best with only a small margin over taxes possible for the legatees.

Furthermore, the executor owes strict accountability to the courts for his action in holding assets of the estate independent of the revenue act. If an executor made an arrangement with the tax authorities and held securities or properties for 2 or 3 or 10 years, and then sold them at a loss as compared with the original inventory, it is a serious question but what the courts would hold the executor liable for such losses on the ground of having failed to exercise prudent judgment. Recently an executor has been held responsible for losses in a large sum for not having sold sufficient of a certain stock to pay the taxes at the time they were assessed, the referee holding the executor responsible for the difference between the market value of the stock at the time the taxes became due, as compared with the price received at a later time.

If for any reason an executor should decide to take advantage of the 10-year period or any part thereof provided in this act, he would undoubtedly be required to put up a bond as authorized by the act, and such surety as the tax authorities might require. If a surety bond should be accepted, the premiums would be very high, if such a bond could be obtained. In cases where the estate has securities to put up the executor takes the risk of their depreciation, as the executor is held bound for the tax individually. Ordinarily, there is no available security in most of these cases, other than real estate, interest in a going business or firm, or stock in some close corporation, as otherwise there would be no occasion for a postponement of the tax. And so it follows that a provision for extension of taxes beyond 1 year is of little help and really dangerous to an executor.

It has been suggested, in instances of the character above stated, and in other instances of larger estates where stock in large amounts is held in one corporation, that bonds might be issued by the corporation to pay these taxes. In the first place, the corporation has no right to issue its bonds and turn the money over to the stockholders, as seems to be suggested. It might be that a corporation could issue bonds and sell them and go through some rigmarole of reducing the value of its capital stock, and thus afford a surplus from which dividends might be drawn. Or, in case of complete ownership of the corporation by the

estate, some arrangement might be made by the estate to form a new corporation and sell the property to the new corporation, receiving therefor bonds for the amount of the tax, and the balance in stock.

But the morals and the sound business policy of such transactions seem to be overlooked. If the prospective bond purchaser knew that in purchasing bonds from a corporation of this sort his money was going to be taken out of the corporation through some method and turned over to the stockholder, it is hardly conceivable that he would buy such bonds. If the information was not disclosed, the bondholder would probably promptly act against the corporation and the seller.

Furthermore, as the combined estate and inheritance taxes in these large estates would run up to nearly 70 percent and in any of the illustrations we have used to a very large amount, it is improbable that bonds could be sold to the public in an amount to produce the sums necessary for the taxes and expenses. The most material consideration to the public in buying such a bond, or to the taxing authorities if they accepted such bonds as payment or as collateral for taxes, would be that the asset position of the corporation would be impaired to the full amount of these bonds and its credit so affected as to seriously jeopardize its successful operation. Furthermore, such bonded indebtedness requires fixed interest payments each year, irrespective of whether the corporation earns it or not, and thus completely changes the possibility of the corporation going ahead and making money, as compared with its former position.

In many of these plans suggested for getting funds from a corporation for the purpose of paying these taxes, substantial income taxes would be involved to the stockholders, thus materially reducing the amount of money available for tax purposes. Raising money through bond issues to pay taxes assessed against stockholders does not seem practicable.

The CHAIRMAN. I desire to have inserted in the record the following communications, briefs, and statements addressed to the committee, relative to the pending bill.

PROVIDENCE, R. I., August 1, 1935.

To the Senate Finance Committee:

I wish to put before you for consideration a plan which, if adopted, should immediately effect a reduction in the number of persons now on relief by causing them to be absorbed by the industries in which they are qualified to work. The success of this proposal depends not upon moneys collected by the Government through surtaxes and excise taxes, but upon specific exemptions from taxation as an inducement to spend.

The unemployed are the chief problem of the Nation today. Without them huge relief expenditures would be unnecessary and the Budget could be balanced. Unless agriculture and business can absorb our unemployed, Federal relief must continue; and so long as Federal relief continues on its present scale, the Budget will remain unbalanced. Every effort should be made to get the people on relief back to their normal work. There is ample capital and wealth in this country for its need and if sufficient inducement is offered to this capital and wealth to relieve the Government of its huge charitable expenditures and put people back to work, results will be both immediate and extensive.

Increased taxation alone will further destroy initiative and increase retrenchment. Even more unemployed may have to go on relief rolls. If, however, specific exemption from taxation is granted for certain classes of expenditure by both individuals and corporations, no person nor company with capital could afford to miss the opportunities offered. Hundreds of millions of dollars of funds now idle would be put to work so that a rapid redistribution of wealth would occur through the reemployment of those now on relief—a far healthier condition than redistribution of wealth through high taxation and Government-supervised relief operations.

Obviously, no plan can, overnight, replace the relief rolls, but this proposal would cause a rapid tapering off in the Government's expenditures for supporting the unemployed. It would give the individual and the business man, whether he be an agriculturist, industrialist, or merchant, the initiative and confidence which is now lacking, to spend his hard-earned and carefully guarded funds, to put people back to work and create the much desired business velocity required to pull us up the road to recovery.

It is claimed that a large portion of the unemployed formerly worked in the construction and so-called "capital goods" industries and that these industries have lagged behind in our recovery progress to date. This proposal, if it should become

law, would stimulate these businesses and their officials and salesmen would broadcast the advantages to the prospective purchaser. There should be no fear that only the alert would know and obtain the benefits of such a law.

Forced redistribution of wealth through higher taxation will make "financial bootleggers" of the individuals and corporations controlling the capital of this country. Forcing methods did not succeed in the N. R. A. nor will they be successful in this tax bill in assisting us to reach our goal. What we need is a plan which will lure, through the use of adequate and timely inducements, the idle funds of the Nation out of hiding and back into useful circulation. Our goal in this emergency, regardless of party affiliations, should be to take the unemployed of the country off the relief rolls as rapidly as possible by putting them back to work in the jobs where, by training, they belong.

Under this plan the farmer would benefit in the purchase of new agricultural equipment and the construction of farm buildings. The home owner would be assisted in the repairs to an existing house or the building of a new one. The merchant and manufacturer would gain on the purchase of any new fixed assets of the type normally subject to depreciation.

Your committee has the opportunity, through the adoption of such an amendment to the present tax bill, to contribute substantially to the rapid elimination of relief rolls and the balancing of the Nation's budget by inducing the idle capital of the country to absorb directly the present unemployed.

I am taking as an example one specific plan. The idea is, of course, subject to many variations.

A. If any corporation shall, during the period covered by the calendar years 1935 and 1936, acquire new (meaning original purchase only) buildings, machinery, equipment or other fixed assets of the type which are normally subject to annual depreciation deductions in an amount exceeding the total depreciation charges for such 2 years as allowed by the Internal Revenue Department, such excess may be set up in a special suspense account and treated as follows:

1. The entire special account must be charged to expense prior to December 31, 1939.

2. These expense charges may be prorated over the 4-year period beginning January 1, 1936, or, at corporation's option, charged off partially or completely in any one of these years.

3. New corporations (in which the majority of capital is represented by new money) organized subsequent to December 31, 1934, shall only be allowed to set up 50 percent of such excess capital expenditures in special suspense account.

4. Every corporation must signify in its return for 1935 tax year, its intention of adopting the suspense-account option for its excess capital expenditures in 1935 and 1936. No change in the handling of such expenditures may be made prior to 1937. No depreciation shall ever be allowed by the Internal Revenue Department upon capital expenditures charged through the special suspense account.

B. Losses on the sale of capital assets of the type normally subject to depreciation shall be deductible from a corporation's net earnings and shall be exempt from the \$2,000 loss limitation now imposed by the present 1934 Revenue Act.

C. During any of the taxable years 1935, 1936, and 1937, an individual may deduct from his total taxable income for that year any amount greater than 5 percent of, but less than 25 percent of, his total taxable income for said year, provided that such amount has been paid out in cash during such tax year for labor, materials, supervision, et cetera, in the building or purchasing of new capital assets of the type which, if owned by a corporation, would normally be subject to depreciation. Such allowance shall be deductible from both normal taxes and surtaxes.

ROYAL LITTLE.

BRIEF IN SUPPORT OF THE PRESIDENT'S RECOMMENDATION TO CONGRESS THAT THE CORPORATE INCOME TAX SHOULD BE CHANGED FROM A FLAT RATE OF 13½ PERCENT TO A GRADUATED TAX OF 10½ PERCENT TO 17½ PERCENT DEPENDING ON THE SIZE OF THE INCOME OF THE VARIOUS CORPORATIONS, BY HARRY K. POINDEXTER, KANSAS CITY, MO.

I. Companies of large corporate incomes can afford more readily to pay higher corporation income taxes on their earnings than companies with smaller corporate incomes due to the fact that:

1. By the very nature of the large sums of money earned, such money can be easily dispersed without inconveniencing employees or stockholders.

2. Employees would not be affected as companies making the earnings would be making a profit and could well afford to maintain their pay roll.

3. Stockholders would be assured of an income over and above their investments; consequently, would not necessarily lose.

II. The corporate incomes of larger proportions would mean either one of two things: Either a nominal earning of a large corporation, or an excessively large earning of a smaller corporation.

1. In case of a nominal earning of a large corporation, the higher percentage of corporate tax would not materially affect the corporation in any other than prevent its undue expansion and further encroachment on the business of smaller corporations.

2. The higher corporate tax on the excessive earnings of the small corporation would merely mean that such a corporation could well afford to pay this additional tax.

III. On account of the national benefits and antisocial tendencies, large corporate earnings should be heavily taxed.

1. Many large corporations are able to make such earnings because they are doing business as national organizations and distributing throughout the entire nation.

a. This advantage is naturally beneficial to them due to the fact that they receive uniform protection throughout the United States; consequently, they should, as a result of Nation-wide distribution, give a larger portion of net earnings back to the people. They receive more of the benefit of the Federal laws such as protective tariff, Government regulation of unfair competition, Interstate Commerce regulation of fair trade practices, protection of copyrights and patents, benefits of Federal Reserve banking systems, etc.

2. The companies having a large corporate earning naturally benefit through some new kind of merchandise which is in popular demand and consequently reap the benefit of national consumption through uniform style or popular taste and thus should be willing to pay their portion with a larger extent of their earnings.

3. Again the corporation receives large corporate earnings due to its size and its ability to buy on a lower cost basis especially when the corporation is a processor of raw materials such as lumber, ores, grains, cotton, hides, wool, and other products raised by agriculture that are manufactured into finished products.

(a) The larger the corporations, the more control they have over the prices of raw materials produced by the unorganized mass of people. By conniving and refraining from purchasing at a given time, they can force market prices downward; thereby, causing a great economic loss to people as a whole. The natural result is that their corporate properties are enhanced; consequently, they should pay a larger proportion of the corporate tax for the commonweal.

IV. A graduated corporate income tax could have a tendency to protect the smaller corporations in their competition with large corporations.

1. If the assumption is correct that the larger the corporation the more economical and efficient the operations, the same argument should be advocated that this tax should be proportionately larger and the benefits of large corporations should go to the mass of people, in part at least, as well as to the original stockholders. The efficiency of the large corporation in itself as to the nature of size alone can be attained only provided there is a large outlet with a large number of customers using its products. It would mean merely a more elaborate profit-sharing arrangement in which the mass of people who are enabling the large corporations to exist would participate. Consequently, the large corporate tax is justified on this premise alone.

2. The graduated corporate income tax would enable the smaller corporations to use a larger proportion of their earnings so as to increase their size and aid them in meeting the competition of larger corporations on a more equitable basis.

(a) A smaller percentage of their earnings being paid into tax naturally would allow an increase of the corporation stock of the smaller corporations to accrue so that their working capital could gradually increase on a greater basis than that of the larger corporations which are paying a higher percentage of tax on their earnings.

V. The principle of the graduated corporate income tax would bring about a better competitive condition in various lines of business activities which would be beneficial to a greater number of the American people.

1. Take, for example, any commercial field such as the dry goods business. At the present time, J. C. Penney's, Montgomery Ward's, and Sears, Roebuck's, which, with their policies of ruthless competition, have relentlessly driven out of existence and destroyed many small independent merchants. If a graduated corporate income tax were in effect it would prevent many commercial tragedies through the expansion tactics in this direction and would enable many small businesses to still exist and expand by providing them greater resistance possibilities in their competition with big businesses.

2. The same would apply in the wholesale grocery business where the Atlantic & Pacific chain stores have the decided advantage due to this accumulative working capital, thus "driving to the wall" many small privately owned industries.

3. The same is true of the meat packing industry. Through accumulated capital earnings they have been forcing out of business many small packers and individual butchers throughout the country.

VI. Graduated corporate income tax would have a tendency to prevent the concentration of corporation capital in the hands of a few at the expense of many.

1. This country is fast approaching a deplorable condition of industrialism in the distributing field with a small group of individuals controlling various lines of production and distribution and the mass of people being forced to remain without any hope of acquiring their own proprietary interests other than as small silent stockholders who have practically no say-so so far as management, dividends, or employment in the firms is concerned. Opportunities for private business initiative are becoming less and less due to the strong entrenchment of the gigantic business concerns.

VII. The graduated corporate income tax would place further expansion on the acquisition of independent fields of endeavor.

1. This would be accomplished by the Government taking a higher percentage of large corporation earnings and allowing the smaller independent corporations to use their earnings in protection of their competition with the larger businesses.

2. An exemption of at least \$3,000 per year in corporation earnings would do much to protect the smaller business man and enable him to continue to exist by the gradual strengthening of his capital structure so as to prevent his being wiped out during periods of business depression.

VIII. Large business concerns often use ruthless methods of competition with small, independent businesses. Small business concerns are thereby destroyed through no lack of efficiency, but due to the enormous power and diversifications of interests existing in the larger corporations.

1. It is a notorious fact that the national chain organizations in meeting the competition of the independent merchant in a given town will reduce prices below cost and drive out an individual competitor, yet which drastic price reductions could not profitably be made in all of their units of distribution. The fact that they can obtain higher prices in communities where competition is not so keen, and adjust to sell in other communities at below-cost prices where competition is stronger, yet maintain a profitable operation for their companies as a whole, gives the larger corporation undue advantage over any individual, independent business. A higher percentage of corporate income tax would be one method of compensating society for the ruinous and ruthless methods of competition indulged in by the large national distributing organizations.

(a) It has been further observed by experiences that as soon as chain organizations drive out a small merchant by discriminative prices in a given community, their prices are subsequently raised to the average higher level of all their other stores.

IX. Individual initiative and self-reliance would be further enhanced as national characteristics of the American people, for more opportunities could be afforded individuals going into business. A graduated corporate income tax would have a tendency to prevent large business institutions from continually absorbing all opportunities of individual business initiative.

X. I respectfully submit to you the following scale of corporate income tax which would be in keeping with the intents and purposes of the President in his previous recommendations to Congress:

Group I.—Exempt all corporations showing earnings of \$3,000 and less from any corporate income tax.

Group II.—Corporate income tax of 10½ percent on \$3,000 to \$5,000.

Group III.—Corporate income tax of 11½ percent on \$5,000 to \$10,000.

Group IV.—Corporate income tax of 12½ percent on \$10,000 to \$25,000.

- Group V.—Corporate income tax of 13½ percent on \$25,000 to \$50,000.
- Group VI.—Corporate income tax of 14½ percent on \$50,000 to \$100,000.
- Group VII.—Corporate income tax of 15½ percent on \$100,000 to \$200,000.
- Group VIII.—Corporate income tax of 16½ percent on \$200,000 to \$500,000.
- Group IX.—Corporate income tax of 17½ percent on \$500,000 to \$1,000,000.
- Group X.—Corporate income tax of 18½ percent on \$1,000,000 to \$2,500,000.
- Group XI.—Corporate income tax of 19½ percent on \$2,500,000 to \$5,000,000.
- Group XII.—Corporate income tax of 20½ percent on \$5,000,000 and over.

I respectfully submit the foregoing brief in support of this plan of graduate corporate income tax, as the executive of the H. T. Poindexter & Sons Merchandise Co., whose earnings for the last year were over \$100,000, and which is acting as distributor to over 40,000 small independent retail merchants located throughout the country. We are not asking any personal benefits as a result of the proposed tax schedule. Also, as chairman of the Kansas City Needlework Trades Association, representing all the manufacturers of articles of cotton materials in greater Kansas City, as vice president of the Trade Development Department of the Kansas City Chamber of Commerce, whose interest is centered upon the welfare of hundreds of thousands of independent producers throughout the great Middle West, I ask you to respectfully consider the proposal as I have outlined it in this brief.

THE PEOPLE'S LOBBY, INC.,
Washington, D. C., July 31, 1935.

HON. PAT HARRISON,
Chairman Senate Committee on Finance,
Washington, D. C.

DEAR SENATOR HARRISON: There is no necessity for anyone to suggest the various tax rates which the Federal Government should impose in order to approximate balancing the Budget.

Government experts can determine what those rates should be better than anyone else, having access to more complete data.

There are several sources of revenue for the Federal Government. Personal and corporate income, liquid corporation surpluses, excess profits, estates, inheritances, including income from Government bonds as part of all income, and a Federal excise tax on the privilege of holding land based on the value thereof.

The essential point for the Senate Finance Committee is to decide whether it will honor the Democratic platform of 1932 which pledged a system of taxation based on the principle of ability to pay.

Obviously the Government can raise as much by taxation as by borrowing. The very least which the Senate Finance Committee can do is to revise the House revenue bill as reported, and to impose substantially the British rates on incomes and on estates, though the rates upon incomes above \$100,000 should be raised above the British rates.

The taxes we have suggested would yield at least \$3,500,000,000 to \$4,000,000,000 more than the Federal Government's present revenue, but will involve reducing the exemption of personal income both for married and single persons, while permitting the repeal of processing taxes on farm products and some other consumption taxes.

A tax upon liquid corporate surpluses would probably yield the largest revenue, because they amounted at the close of 1932, the last year to which we have access, to approximately \$18,000,000,000.

Congress should impose a small excise tax on the privilege of holding land, as provided in the Moritz bill, since most Federal expenditures are maintaining or increasing land values.

It seems obvious that the tax program we have advocated is the only alternative to dangerous inflation. I have submitted facts and figures to the House Ways and Means Committee, in their recent hearings on the revenue bill. I am going abroad, and will not be able to testify Friday as your clerk of the committee suggested, and am therefore writing this letter which please incorporate in the record.

Yours sincerely,

BENJAMIN C. MARSH,
Executive Secretary.

STATEMENT OF C. C. LaRUE, CHAIRMAN OF THE FEDERAL TAX COMMITTEE OF THE ILLINOIS MANUFACTURERS' ASSOCIATION

Gentlemen, my name is C. C. LaRue. I am chairman of the Federal tax committee of the Illinois Manufacturers' Association of 120 South LaSalle Street, Chicago, Ill.

I am appearing here on behalf of the Illinois Manufacturers' Association in opposition to H. R. 8974—Revenue bill, 1935.

The Illinois Manufacturers' Association represents Illinois industry. It has 2,500 members, employing normally approximately 600,000 wage earners. Its membership embraces every line of manufacture in the State.

The statement which I wish to present to this committee represents the conclusions which have been arrived at by the Federal tax committee of the association—a committee of representative men familiar with problems of Federal taxation—after numerous discussions of the provisions of the bill.

We wish to direct our observations to the provisions of the bill relating to increases of the tax rates on corporations, both as to income and excess profits.

In the first place, we respectfully submit that the graduation of corporate income taxes solely on the basis of the amount of income of the corporation is unsound and unwarranted. Although the amount of graduation has been materially changed from that originally proposed at the time the Ways and Means Committee of the House was holding its hearings, it has not been eliminated.

It is still subject to the same objections. Any graduation of rate of corporate income taxes based on the amount of income alone is inequitable, discriminatory, and will tend to retard industrial advancement. Such a discrimination is economically unsound in principle and practice. Such a principle, once it is incorporated in the corporation income tax, will inevitably impair confidence in governmental policies on the part of business and industry.

The amount of the income of a corporation has no relation to the amount of profit on its invested capital, nor does it have any relation to the amount of income derived from the corporation by its stockholders. It is unnecessary to prolong this statement by illustration of this well-known and undisputed fact. It is sufficient to point out that in the case of one great American corporation, whose stock is owned directly or indirectly by 415,000 stockholders, 150,000 of these stockholders own 10 shares or less. This is generally the situation in the case of large American corporations.

A graduated corporate income tax will directly affect the income of the millions of small stockholders of these corporations.

Second: The material increase in the rates of excess-profits taxes on a graduated scale is absolutely unwarranted and unjustifiable at this time.

The crying need at the present time is increase of employment. This employment must be furnished by manufacturing and business corporations. At the present time, with business as it is, it should be given a breathing space sufficient to engender confidence.

It is well known that the surpluses of all corporations have been seriously impaired during the past 5 years—and in many cases, they have been completely destroyed. It is equally well known that it was the fact that such surpluses existed that enabled many corporations to continue in business and furnish employment—and that most corporations without such a surplus have fallen by the wayside.

The imposition of a graduated excess-profits tax, ranging from 5 to 20 percent—in addition to the graduated income, the pay-roll taxes under the Social Security Act, and the numerous other impositions of State and local governments—would necessarily further weaken the strained financial position of great numbers of corporations, and result in business failures and further unemployment.

The necessary and inevitable effects of the passage of this bill would be:

1. To decrease wages to employees through increased costs and in reduction in controllable costs.

2. To increase costs to consumers of commodities of all kinds.

3. To decrease the income of all investors.

4. Operate as a regressive and not a progressive tax.

The primary requisite to improved business conditions is the reduction of unemployment. Any permanent and substantial reduction in the ranks of the unemployed can result only from the stimulation of productive enterprise. A further increase of the already tremendous tax burden now carried by taxpayers will retard and prevent that stimulation. The desired results can best be obtained by a real reduction in present tax burdens through the curtailment and elimination of Government expenditures.

EFFECT OF PROPOSED FEDERAL TAXES ON FORESTRY

STATEMENT OF WILSON COMPTON, SECRETARY AND MANAGER OF NATIONAL LUMBER MANUFACTURERS ASSOCIATION, BEFORE THE SENATE FINANCE COMMITTEE

This statement is made in behalf of the National Lumber Manufacturers Association and affiliated organizations representing the lumber manufacturing industry in every timber region of the United States. I wish to comment briefly on two of the proposed tax features:

1. The effect of the proposed combined estate and inheritance taxes upon continuity of forest industry operations, sustained-yield management of forest lands, and security of employment and livelihood in forest communities.

2. The graduated corporation income-tax rate.

High inheritance and estate taxes as understood to be contemplated, as applied to ownership of operating forest lands, will discourage if not ultimately destroy permanent reproductive management of individually owned timber lands. Or it will drive all forest land eventually into large corporate ownership; or into public ownership. In any event it will discourage the very type of socially responsible individual ownership and enterprise which at other points this Government is seeking to encourage.

With minor exceptions, efficient, low-cost, and permanent forest industry operation does not lend itself to small-unit ownership, as in farming. The national experience in the administration of the general land laws has demonstrated that. The attempted policy of dividing forest land ownerships into the same-sized units as farms was almost universally nullified by the economic necessity of larger forest-industry operating units. This experience parallels that of other forested countries, such as in central and northern Europe, where private forest-land ownership large enough to maintain permanent communities and sources of employment on an efficient basis is not only permitted, but actively encouraged as desirable public policy.

Not only so, but the continuity of ownership and operation is further ensured and encouraged by various forms of entail intended to keep intact from generation to generation the unit forest ownerships upon which much community dependence is founded. Especially is this true of the north and central European countries, which during the past two centuries have made the transition from transitory forest industry to stable and dependable permanent sources of community support.

The United States is in the midst of the same transition. The transition began about a quarter of a century ago. It will last for at least another quarter of a century. It will be either expedited or retarded by the policies of Government. Public taxation policy will largely determine the future of forest ownership in this country. Sustained yield management of forest lands will be practicable largely to the extent that State and local taxation refrains from forcing timber cutting merely to pay taxes. Permanence of forest-industry operation and community maintenance will depend largely upon the extent to which the Federal Government, in its taxation of income, estates and inheritance, observes the experience of other nations under like circumstances in encouraging continuity of properly operated forest ownerships.

Twice during the past 15 years the Senate has seen fit to include in Federal income tax bills, liberal provisions permitting the deduction from taxable income of expenditures incurred for reforestation of timberlands. There obviously was no justification for such provision other than in the national interest to encourage reforestation.

To call the attention of the Finance Committee to the similar problem involved in the tax proposals now before you is well warranted by the obvious social as well as revenue purposes of the pending legislation. There is now more general recognition of the fact that the predictions of a national timber famine in the sense of a shortage of desirable forest products have been greatly exaggerated, and that the public has a larger interest in the indirect forest benefits relating to regulation of stream flow, erosion, recreation and even more, continuity and security of employment.

These are public benefits inherent in proper forest management and utilization. They may deserve some recognition by Congress in the determination of the extent if any to which it may wish, through limited exemptions under the Federal inheritance and estate tax laws, and under proper standards and safeguards, to encourage, or at least refrain from discouraging, permanent forest management and forest industry operation in private ownership.

If the Finance Committee cares to explore further these facts and problems and practical ways of serving the permanent national social purposes of the legislation now under consideration, it will of course have available to it the facilities of the United States Forest Service.

My purpose in coming to the committee at this time is simply to point out the plain fact that the conclusions reached by the Congress on this and similar fundamental tax legislation will largely determine the future extent of private forestry enterprise. The obvious alternative is of course public ownership. But it is only fair to say that no country has found a solution of its forest problem in sole or even principal public ownership; and that the countries which have made the greatest advances in forestry continue their principal reliance upon private forest ownership and management, under proper public regulations.

As to the corporation income tax we see no logic, propriety or advantage either public or industrial in a graduated scale of rates which would impose upon higher corporate incomes a higher rate of taxation. Where, as is often the fact, large-scale enterprise and large-unit forest ownership are necessary to efficient timber utilization, permanent operation, and security of community maintenance and employment, there is no public gain and much public loss in penalizing size. Properly managed sustained yield forest industry operations, whether they be large or small, should be stimulated, not discouraged by penalty taxes.

ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK,
COMMITTEE ON TAXATION,
42 West Forty-fourth Street, August 7, 1935.

HON. PAT HARRISON,
Chairman Committee on Finance,
United States Senate, Washington, D. C.

DEAR SIR: Referring to the pending revenue bill of 1935, the Committee on Taxation of the Association of the Bar of the City of New York, while not presuming to criticize the tax policies expressed therein, does feel competent to comment on the machinery designed to effectuate such policies.

First, with respect to the so-called "excess-profits tax" provided for in section 105 of the bill, based on the "adjusted declared value" of the stock of corporations, it is stated in the report of the Committee on Ways and Means (No. 1681, 74th Cong., 1st sess.) at page 8:

"Your committee does not provide in this bill for another original declared value, being of the opinion that since the corporations have already had two opportunities to set a proper value on their capital stock, it would be unnecessary from an equitable standpoint to provide another original declaration. * * *

"The excess-profits and war-profits taxes imposed during the war were similar in character."

The second proposition of the quotation is a misstatement; the first proposition is misleading and misconceived.

During the war profits taxes were imposed on the basis of invested capital—that is, the investment in the business, ascertained by carefully drawn formulas. There was also a capital-stock tax based on valued capital, that is, the current value of the capital stock, ascertained each year by comparing market prices of the stock, book value of the assets, and previous earnings. The two bases, invested capital and capital-stock value, had no necessary relation to each other, and only at the moment of organization of the corporation were they ever likely to be the same. The theory of an excess-profits tax was, and is, the progressive taxation of income realized in excess of a fair return on the actual investment in the business, regardless of the current value of the business.

After the repeal of both the old excess-profits taxes and capital-stock tax, a new and novel capital-stock tax was imposed in 1933, and reimposed in 1934, based on the value of the capital stock as originally declared by the taxpayer, without possibility of revision from year to year due to changes in value, except for adjustments in surplus. At the same time a new excess-profits tax, having no resemblance to the war excess-profits taxes, was imposed at the rate of 5 percent on the income of the taxpayer in excess of 12½ percent of the value of the capital stock declared for capital-stock tax purposes. As the capital-stock tax was \$1 per \$1,000 of declared capital-stock value, and the 5 percent excess-profits tax much more burdensome, the inevitable and intended result was that corporations attempted to declare a value for capital-stock tax purposes equivalent to eight times their estimated future annual earnings. Obviously it was a gamble in

which the corporation always lost and the Treasury Department always won. If the corporate earnings did not come up to expectations, the corporation paid too high a capital-stock tax; if the earnings exceeded expectations, the penal excess-profits tax became applicable. No one in or out of the Government ever regarded the declared capital-stock value as having any relation to actual capital-stock values, except as the multiplication of prospective earnings by 8 might be one factor in determining actual values. The capital-stock tax so measured was faulty in theory and based on guesses of the future which might be wide of the mark, but it could perhaps be defended because of its simplicity and low rate.

Now, however, the present bill proposes a so-called "excess-profits" tax, beginning on income in excess of 8 percent of, not the invested capital of the corporation, which is the only true basis for an excess-profits tax; not even the actual value from year to year of the capital stock, although capital-stock value has no proper bearing on an excess-profits tax; and not even a new declared value of capital stock, to be fixed with reference to the radical new taxes; but on income in excess of 8 percent of the old declared capital-stock value, fixed only with reference to a capital-stock tax and to the avoidance of a penal excess-profits tax, which Congress intended should thus be avoided. The proposal is to base a graduated excess-profits tax, not on invested capital, but on an arbitrary capital-stock value, fixed for the purpose of another tax, and having no conceivable relation to the determination of excess profits. It is so farcical and fantastic that it could be dismissed as merely ridiculous if the prospect of enormous injustice were not involved. For example, a corporation with an investment of \$1,000,000 with low annual earnings of \$25,000, which had accordingly declared a capital-stock value of \$200,000, would pay an excess-profits tax on \$9,000 of its \$25,000 of income, although that represented only 2½ percent on its invested capital, while another corporation with an investment of \$50,000, with high earnings of \$50,000, which had accordingly declared a capital-stock value of \$400,000, would escape any excess-profits tax on income up to \$32,000, although that represented 64 percent on its invested capital.

The adoption as a basis for new graduated excess-profits taxes of an arbitrary capital stock value heretofore irrevocably fixed for capital stock tax purposes is an indefensible breach of faith, but the objection to this measure of the excess-profits taxes is even more fundamental. No excess profits tax designed to provide revenue, and not merely as an avoidable penalty, can be measured by any yardstick other than invested capital without disregard of the function of an excess-profits tax and without gross inequity.

Second, with respect to the inheritance taxes and gift taxes on donees, the President in his message to Congress of June 19, 1935 (Committee on Ways and Means Report No. 1681, 74th Cong., 1st sess.), said that studies by committees of Congress "have made it very clear that we need to simplify and clarify our revenue laws." This proposition we heartily support. Opposed to such simplification and clarification are the inheritance and gift tax provisions comprising pages 8 through 96 of the revenue bill. These provisions will accomplish untold complication and confusion if adopted in their present form. We shall have, in addition to the estate taxes of the various States, two sets of Federal death taxes and two sets of Federal gift taxes, all of them intricate and difficult of determination and administration. There is a limit to human capacity to prepare returns and calculate tax liability.

No proper purpose can be served by precipitate passage of provisions which because of their novelty and ramifications should receive months of advance study. The proposed taxes, which are imposed separately on several legatees instead of one estate, and on possibly several donees instead of one donor, are necessarily even more complex than the existing estate and gift taxes, and require exceptional clarity of statement, which cannot be achieved in a hurry. Frankly, we are not sure what several of the sections mean, including those referring to corporations for avoiding tax (secs. 202 (b) (c) and 302 (b) (c)) and to dower, curtesy, and "statutory estates created in lieu of dower or curtesy" (secs. 203 (b) (e), 303 (b)); and we would expect extensive litigation to follow their enactment. Section 203 (a) (7) might mean that an insurance policy which had been absolutely assigned, whether for good or valuable consideration, more than 2 years before death would still be subjected to the inheritance tax, a result which could scarcely have been contemplated.

In conclusion, we believe that there are vital defects in the bill, largely due to the haste in drafting it and to the lack of consideration which can be given its novel provisions in so short a time. As it stands, quite aside from matters of policy and purely as a matter of logical theory and workable machinery, it is

a poor bill. If enacted before exhaustive study and revision it is bound to be a poor act. If we can be of any help to your committee or its counsel in amplifying our views or discussing provisions of the bill, one or more of our number will be glad to come to Washington for such purpose.

Yours very truly,

HUGH ATTERLEE, *Chairman.*

MEMORANDUM RESPECTING THE PROVISIONS OF TITLE II AFFECTING INSURANCE PAYABLE AT DEATH SUBMITTED BY RAY D. MURPHY, JAMES F. LITTLE, AND F. G. DUNHAM, SPECIAL COMMITTEE OF ASSOCIATION OF LIFE INSURANCE PRESIDENTS

SECTION 210 (A)

It is feared that this section, dealing with all kinds of property, requires an administration of insurance death claims which would result in real hardship to very many beneficiaries under insurance contracts. This effect possibly may not have been entirely realized and would seem to deserve earnest consideration as to the possibility of relieving the situation without loss of revenue to the Government.

This section would require insurance companies, "under liability to make any payment to the beneficiary", to deduct the tax from the amount payable to a beneficiary.

This means that before payment of any death claim the insurance company would have to make inquiry as to the total amount passing at the death to the beneficiary under the insurance policy in order to determine whether a tax is payable, and if so, the rate of such tax. In no other way could there be ascertained the amount of tax to be withheld. Even in the case of relatively small policies inquiry might disclose that the total value of property transferred would involve a tax, so that no death claim could safely be paid without inquiry as to the extent of the estate passing to the beneficiary.

As the amount passing to any particular individual is affected by the estate tax on the total estate, it would not be possible to determine the amount passing to an individual beneficiary until the entire estate had been finally determined and the estate tax assessed. It would not be possible otherwise to establish the amount passing to any beneficiary upon which the rate of this tax would depend. The delay resulting from this situation would cause much distress and would raise a storm of justified protests from the beneficiaries under insurance policies maturing by the death of the insured. The vast majority of these beneficiaries would not be subject to tax but would, nevertheless, have to wait sometimes for many months, before receiving the benefits to which they are entitled. Experience shows that in well over 90 percent of insurance death claims there is only a small estate and money is urgently required for the ordinary necessities of life, after the breadwinner's income has ceased. To a large section of the population, therefore, the delay from this feature of the administration of the tax would be little short of a disaster.

The object to be sought in the premises—a check on the collection of the tax—can be accomplished by the means employed in several States in which the insurance companies report to the tax collecting authority all death-claim payments as to which information is deemed to be necessary. The limits and regulations to govern reporting might properly be left to the Commissioner of Internal Revenue. A minimum amount of reportable claim might be fixed such as would take care of all cases where a tax was likely to be payable and at the same time relieve the tax authorities from the handling of immense numbers of reports which have no effect on the revenue. For example, such regulations might require reporting claims of more than \$2,000 where, under section 205 (b) the exemption would be \$10,000, and claims of more than \$10,000 where the exemption would be \$50,000.

The change above suggested might be effected by adding at the end of the present section 210 (a) the following: "nor to proceeds of insurance policies payable by reason of the death of the insured, but payment of such proceeds shall be reported by the insurer immediately upon payment in the form and to the extent that the Commissioner, with the approval of the Secretary, may require."

SECTION 203 (A) SUBSECTION 7

This provision would appear to treat transfers of insurance more severely than transfers of other property. The provision as it stands would apparently levy a tax in the case where an individual had taken out a policy and thereafter transferred it to some other party by gift or for full value. In the case of gifts of property, other than insurance, the transfer would not again be subject to tax upon the death of the donor; nor would other property sold for full value be subject to tax on the death of the transferor.

There does not seem to be a really satisfactory ground for distinguishing sales or gifts in the form of insurance benefits from transfers of other property.

If the words in the text of the present clause (line 21, p. 18) reading: "even though" were changed to "unless" the effect would be to treat property in the form of insurance contracts the same as other property. It would not have a special advantage nor would it be placed at a special disadvantage.

THE ASSOCIATED BUSINESS PAPERS, INC.,
New York, N. Y., August 2, 1935.

Hon. PAT HARRISON,
United States Senate, Washington, D. C.

MY DEAR SENATOR HARRISON: The enclosed statement has been released by the Associated Business Papers, Inc., an association of 127 leading business publications having national circulation of approximately 2,000,000 American business men.

The statement reflects the views of members on the impending tax bill and our association respectfully submits it to you as Chairman of the Senate Finance Committee with the intention that you file it as an expression of their opposition to the tax bill introduced by Representative Doughton.

Respectfully submitted.

H. J. PAYNE,
Executive Vice President.

BUSINESS PAPERS HOLD TAX BILL THREAT TO BUSINESS RECOVERY

BUSINESS PUBLISHERS RECOMMEND FURTHER DELIBERATION ON TAX MEASURE WITH ACTION DELAYED TILL NEXT SESSION OF CONGRESS

The most important contribution business or government can make to public welfare today is the restoration of business confidence, according to a statement issued by the Associated Business Papers, an association of 127 of the leading business papers in the country.

The publishers point out that there is much factual evidence to indicate that business men are making plans for increased fall business and definite though less tangible reason for believing that the fears which pervaded all business during the early summer are disappearing. The restoration of confidence and the revival of business seem more directly threatened by the tax measure now before Congress than by any other pending legislation.

President Roosevelt stated the business point of view quite clearly in his Budget message last January. He said the only thing which stood between the Treasury and a balanced Budget was extraordinary expenditures for relief, and that these expenditures and this distortion of the Budget would cease only as private industry revived and employment was afforded to those on relief.

Business neither fears nor opposes increased taxes, according to the publishers. On the contrary it realizes that only by a material increase in taxes can the Budget be balanced and a sound national economy established. It believes that business recovery would immediately reduce the Treasury deficit, eventually relieve the Government of all Federal relief expenditures, and broaden the base from which Federal taxes are obtained.

A restored industry will be willing and able to pay the tax increase necessary to meet Federal requirements. Business fears the underlying theory of the pending tax bill without immediate concern for the amount of revenue it would provide or the source from which that revenue would be drawn.

The statement urges that since the necessity for maintaining business confidence is obvious and almost universally admitted, it would seem advisable to undertake at once and pursue with all possible speed a thorough study of the fiscal needs of the Treasury and the sources from which they may be met, so as to present to the

next Congress a mature and constructive tax program. Present procedure in the matter promises a tax return that is wholly inadequate. It promises also to destroy confidence, retard recovery, and deplete indispensable sources of tax revenue.

AMERICAN TAXPAYERS LEAGUE, INC.,
Washington, August 8, 1935.

HON. PAT HARRISON,
Chairman Senate Finance Committee, Washington, D. C.

MY DEAR SENATOR: On behalf of the American Taxpayers League, Inc., of which I am vice president, I desire to submit for the consideration of your committee the attached brief containing the League's views on the tax measure now being considered by your Committee.

Very truly yours,

ISAAC MILLER HAMILTON.

BRIEF FILED BY COL. ISAAC MILLER HAMILTON, PRESIDENT FEDERAL LIFE INSURANCE CO., CHICAGO, ILL., VICE PRESIDENT AMERICAN TAXPAYERS LEAGUE, INC., WASHINGTON, D. C.

A sound tax policy must take into consideration three facts. It must produce sufficient revenue for the Government; it mustlessen, so far as possible, the burden of taxation on those least able to bear it; and it must also remove those influences which might retard the continued steady development of business and industry on which so much of our prosperity depends. Taxation should not be used as a means of rewarding one class of taxpayer or punishing another. Any public official who attempts to promote legislation by arraying one class of taxpayers against another shows a complete disrespect for those principles of equality on which this country was founded. The American taxpayer, in our opinion, is perfectly willing to meet his constitutional obligations within reasonable limitations. He is, however, opposed to the use of our taxing system as a means of social reform or as a weapon of destruction of any group or class of citizens.

Practically all commentators and many of the members of the House Ways and Means Committee and the Senate Finance Committee have stated openly that the primary purpose of the bill which is now before your committee for consideration is to break up large fortunes; to diminish and limit large corporations; and that revenue is a minor or incidental issue. The most optimistic estimates that have been so far advanced indicate that the increased revenue expected from the increases in tax rates will not be sufficient to defray the current expenses of the Federal Government for a period in excess of 2 weeks, and they certainly will not raise sufficient money to make a dent in the national debt. There are in this measure dangers which, we believe, more than amply support the contention that this measure, originally dictated by political expediency and still dominated by political expediency, should be rejected forthwith.

It seems to us that in the current discussions of your committee the question of the direct relations between taxes and high unemployment should be given careful consideration. The plain fact is that in every period of history of which we have record, high taxation is accompanied by high unemployment, except during the early stages of inflation when rising prices negative the taxes. Unemployment is the most serious problem in the world today and it does not help matters to conceal the true condition.

Apparently the objective of a section of the taxes now being considered by your committee is to keep all incomes at depression levels. In that case, the market for many articles of merchandise will disappear. Also will disappear the donations to charitable, research, and educational institutions, hospitals, and similar organizations, along with the ability to finance new ventures. The Government will take over the funds and those who have been employed in the manufacture and the servicing of the luxuries of the so-called "rich" will find themselves without jobs. It is the income of the people from whom work is withdrawn that will be redistributed, and not the income of their wealthy employers.

Senator David I. Walsh, of Massachusetts, a member of your committee, in a recent talk entitled "The New Tax Program", broadcast over a Nation-wide network of the National Broadcasting Co., pointed out this fact in the following striking language:

"In my judgment, if we do not proceed with extreme caution, all this source of employment—in the past representing a small army of contented workers—will be wiped out. Indeed they are fast being wiped out. A taxation system

that confiscates through taxes by both the State and Federal Governments will be the last straw."

"How paradoxical to advocate in one breath means to increase industrial employment and plead in another breath the specious doctrine of 'Soak the Rich', which, when prompted by punitive motives, will deprive large numbers of employees of their present jobs and send them into the overcrowded industrial centers to compete for jobs under the so-called 'slave system' of modern industrial life."

High rates of taxation inevitably put pressure upon the taxpayer to withdraw his capital from productive business and invest it in tax-exempt securities, or to find other lawful methods of avoiding the payment of taxable income. The result inevitably is that the sources of taxation are dried up; wealth fails to carry its share of the tax burden; and capital is diverted into channels which yield neither revenue to the Government nor profits to the people. The net result is that unemployment increases; the laborer is thrown out of work; and the wealthy taxpayer therefore is not the one who suffers, but rather the laborer who is deprived of the means of earning a livelihood for himself and those dependent upon his daily wages.

It seems difficult for many to understand that high rates of taxation do not necessarily mean large revenues to the Government, and that more revenue may frequently be obtained by lower rates. Striking proof of this statement is found in the tax yields during the years of 1924 and 1927. During the year 1924, when the maximum normal and surtax rates were 46 percent, the Federal Government collected in individual income taxes, \$704,265,390. In the year 1927, when the maximum normal and surtax rates were 25 percent, the Treasury collected in individual income taxes, \$830,639,434. Thus in 1927, with a maximum rate of 21 percent below that of 1924, the yield to the Federal Treasury was \$126,374,044 greater than in the year 1924. The striking point in a comparison of these returns lies in the fact that the increased yield began in the brackets showing incomes of \$50,000 per annum, and increased progressively in the brackets in which the income was \$1,000,000 per annum and over. In these groups, the yield in 1927 was \$176,278,726 more than in 1924.

Henry Ford, one of the outstanding examples of American leadership in the industrial world, recently stated:

"High taxes on the rich do not take the burden off the poor. They put burdens on the poor. So far as our company is concerned, we can go on about as we now are, whether the surtax is 25 percent or 50 percent. We can make some improvements, but we cannot do the great things we should do had we more money. We cannot make such progress in the next 15 years as we have in the last 15, and all other forward-looking companies will be in exactly the same boat."

High surtax rates present an open invitation to all men who have wealth to be relieved from taxation by the simple expedient of investing in the many billions of tax-exempt securities now available, and which will be unaffected by any constitutional amendment. High surtax rates, therefore, do not bear heavily upon the man who has acquired and holds available wealth, but on the man who, through his own initiative, is making wealth. The idle man is relieved, the producer is penalized, and the workers are the greatest sufferers.

The sane approach to the whole problem, however, would be a revision of the income-tax schedules so as to reduce extremely high rates on the upper brackets. This would make tax avoidance by this means so much less attractive. It would result in a larger total yield from the income tax, making less attractive the purchase of tax-exempt securities. It would appear, therefore, that this should be chosen as the more desirable course of action.

Confiscatory income taxation tends to defeat itself through encouraging a flight to tax-exempt securities and nonincome-bearing projects. Particularly at a time when business recovery is so urgently desired, encouragement to capital to enter nonproductive channels is hardly a logical course of action. All previous experience has amply demonstrated the fact that high income taxes give distinct encouragement to municipal extravagance. By placing a high artificial premium upon the purchase of State and local government bonds by wealthy investors, they facilitate the sale of obligations of separate political entities that do not deserve due credit.

The proposal for a graduated income tax on corporations rests on entirely different grounds. The size of a corporation's net income bears no necessary relation to the wealth of its individual shareholders. The actual ownership of the largest American corporations is widely diffused and it has been estimated

that there are over 5,000,000 of these shareholders, or stockholders, scattered throughout the country. The clear inference seems to be that the intent of this proposal is to place large corporations at a disadvantage in competition with smaller enterprises. If this be the case, we are of the opinion that this provision is the least defensible in the entire tax program. It is by encouraging, not discouraging, large-scale industrial expansion that the Government can best help workers to recover their jobs in the present crisis. The present high standard of living in the United States is due largely to the theory and the practical application of the mass production principle, the production of standardized merchandise in quantity lots and its sale at reasonable prices to the consumer.

The ethics of this theory combine four elements—increasing quantity, increasing quality, broadening markets, and decreasing prices. That is the true formula. Its application brings bigness. It also brings benefits in terms of individual comforts to the masses of our people. Under this formula we grew big and then we bogged down. In all this process, however, a new formula was found; a formula which should not be junked in behalf of a return to smallness just because the system produced serious evils, along with tremendous benefits. Possibilities still latent in this formula are so great, in terms of general economic welfare, that the job is to make it work, to correct its evils, not to destroy it.

The chief justification for corporation taxes is their great administration convenience. The earnings exist in large pools; there is great publicity surrounding them; and tax evasion is difficult. Experience has proved that the best tax on corporations is a flat tax, at not too high a rate, on net earnings.

The proposal to levy a progressive corporate income tax at rates of 10 to 17½ percent, in face of the present uniform rate of 13¾ percent is not itself of great financial significance. What is involved in the progressive corporate income-tax proposal is not a new monetary burden on substantial size nearly so much as a vital principle. Experience teaches that once the principle of progressive rates is applied to a tax, it can grow and become more pronounced.

The size of a corporation's income has no relation to its net profits, and hence its ability to pay taxes. It must be clear that the rate of return upon a corporation's investment, rather than the aggregate size of its income, determines its ability to contribute to the upkeep of the Government.

The high rates proposed in the present tax measure are of doubtful wisdom at a time when business enterprises are just emerging from a prolonged depression, and in many cases face the urgent necessity of rebuilding impaired reserves out of the more liberal profits of prosperous years.

Large scale production and distribution, as already stated, are essential characteristics of modern American industry. The large enterprise is absolutely inevitable in a number of industries, such as railroad transportation, communications, etc. To impose higher taxes merely because a corporation is large is to penalize bigness, and often necessary bigness, as such.

From an economic standpoint, the soundest policy is to place large and small enterprises in each industry in a position where they can compete freely to prove their relative worth. If, without indulging in unfair and misleading trade practices, the large enterprise can gain at the expense of the smaller rival, it is in the national interest to permit it free scope. The ultimate objective of economic policy should be to raise and maintain the living standards of the population. This principle has already been announced by the present administrative heads of our Government. This can be attained best by lowering production costs and prices to the consumer generally. The size of individual business units, therefore, should be permitted to adapt itself to serve this end most effectively.

It is our opinion that the proposed graduated levies on corporation income taxes would impede rather than aid the cause of business in recovery in the alleged interests of social reform.

Large corporate enterprises tend to lead in business recovery, so that to penalize and discourage them now by graduated income taxes, or even by heavy excess profit taxes, would be to hamper further the return to prosperity.

We are opposed to that section of the Federal tax program which recommends higher estate and inheritance taxes on the ground that such rates will tend to dissipate the aggregation of wealth on which industry depends for its capital, and on which the Government depends for a substantial part of its revenue under the present income-tax rates.

We cannot accept the theory that a large fortune is a public menace, to be destroyed by taxes when its holder dies. Many such fortunes have passed into the hands of excellent custodians who employ them for constructive purposes. The desire to assure continuance in the family of the possession and development

of a going business is a strong inducement to the hard application of energy and prudent administration of affairs. The knowledge that estate and inheritance taxes will defeat such a purpose would mean inevitably a lessening of incentive on the part of men of ability. Undoubtedly they would be unwilling to lend themselves to the establishment of new enterprises. There are numerous instances throughout the history of the country where fortunes were employed in a manner to insure increased employment, development of whole sections or entire communities, and to increase efficiency in production and trade with benefit to the whole Nation.

The combination of estate and inheritance taxes proposed in the measure now before your committee would bring these levies nearer to the confiscatory limit than any tax proposal ever suggested in this country in our tax system. At first glance it would seem that these confiscatory estate and inheritance tax levies look like a plan for sharing the wealth. However, this is merely looking at one side of the picture. Any good wealth-sharing movement must not only take away from the few, but also spread the benefits among the many.

Heavy estate and inheritance taxes will force liquidation of assets, resulting in a change of ownership of physical properties used for productive purposes. Such forced changes of ownership are bound to interfere materially with the orderly functioning of productive equipment, and in some cases would compel a complete cessation of operation and a closing down of factories, resulting in wide-spread unemployment and in a waste of valuable productive facilities.

The practical difficulties in administration of the proposed estate and inheritance tax levies are too well known to the members of your committee to call for comment. Even through forced liquidation, it will be a physical impossibility to meet the Government requirements in the way of tax payment. Actually, the Government does not and cannot tax wealth in any material sense. It does not want to take over stocks, bonds, real estate and business concerns. It merely wants each year a sum of cash, constituting a claim of part of the current income of the Nation, so that it can defray its own outlays and necessary expenses. The only alternative is for the Government to take over actual possession and control of these projects. This, in the final analysis, means a state of socialism.

The confiscatory estate and inheritance taxes suggested in the pending tax measure will introduce a new element of uncertainty and confusion in the market for securities, real estate and other types of fixed property. The death of a wealthy man, more than ever before, would be a signal that the market for the classes of property which figure prominently in his estate has been placed in jeopardy. Stability of control of business enterprises would be jeopardized in many instances. Such levies would tend to hamper a return to stable conditions in the real estate market, which is one prerequisite to a resumption of the normal volume of building construction.

There is still another special reason for not increasing the inheritance taxation further. Until 1926 the States obtained the major share of death taxes. An estate was granted a credit up to 80 percent of the total Federal impost on account of payment to the State. Since then, additional Federal taxes have been imposed that give the State governments a dwindling share of the income from estates. If inheritance taxes ranging from 4 to 75 percent should not be imposed in addition, as proposed, the States will find that they are continually being forced out of one of the few major sources of revenue that are left to them in these times when the Federal Government is so rapidly preempting the field of taxation.

We believe it is a reasonable supposition that the main purpose of the President's suggestions on estate and inheritance taxes is an attempt to redistribute wealth and incomes rather than to bring the Federal Budget into a more nearly balanced condition. We cannot shut our eyes to the fact that a principle of the utmost importance is being proposed—one that may set a precedent for tax policies for many years to come, and one which will have far-reaching effects upon the business life of this country.

No matter what may be advanced in the way of argument as to social purpose or other justifications, we cannot afford, in such a period as now exists, to discourage the enterprise of willing people and force shut-downs of active businesses or violent changes in ownerships through forced transfers, to obtain some taxes from an estate or inheritance tax plan, which, if devised with all due caution, can produce, under the fiscal conditions likely to exist during the next few years,³ but a very small proportion of the Government's total revenue.

We, therefore, most earnestly urge upon your committee, that in the furtherance of public interest, and as a principle of fair treatment in private investments and individual rights, that no schedules of taxation be adopted that will tend to

dissipate large fortunes or drive them into avenues of escape, or that will hamper the orderly functioning of business enterprises that are needed so greatly at the present time to furnish employment in this country.

AMERICAN TAXPAYERS LEAGUE, INC.,
Washington, D. C., August 8, 1935.

HON. PAT HARRISON,
Chairman Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: Referring to my note of August 8, submitting on behalf of the American Taxpayers League, Inc., brief on the pending tax measure before your Committee, I desire to supplement this brief with the attached copy of resolutions adopted at a meeting of Chicago home owners and taxpayers associations, under the auspices of this league.

Very truly yours,

ISAAC MILLER HAMILTON.

RESOLUTIONS ADOPTED AT MEETING OF CHICAGO HOME OWNERS AND TAXPAYERS ASSOCIATIONS, UNDER AUSPICES OF AMERICAN TAXPAYERS LEAGUE, INC.

A meeting was called at the Hotel Sherman August 5, by the State committee of the American Taxpayers League, Inc., for the purpose of considering the revenue measure now before Congress. Among those participating in the meeting were officials of more than 100 taxpaying groups, representing the home owners and wage earners of Chicago. They speak officially for a membership of 250,000, and reflect the sentiment of the citizens of Chicago.

The meeting was presided over by Mr. Thomas Cody, State director of the American Taxpayers League, Inc.

The following resolutions were adopted unanimously:

Whereas Congress has under consideration enactment of a tax measure that is estimated to add approximately \$275,000,000 annually to the already crushing burden of the Nation's taxpayers.

Proposed as a budget-balancing measure, it has been stripped of this thin camouflage and revealed as a crushing blow against the thrifty.

Those who toil are the people who will have to foot the bill in the end, no matter on whom it first falls.

The reasons are obvious. The confiscatory rates of the measure will drive more capital than ever before out of productive fields into tax-exempt securities, the only place where it will be able to escape governmental confiscation.

Thus, productive enterprises will be denied the lifeblood of new and increasing investments of capital so sorely needed at this time to strengthen and rebuild the economic structure.

When capital, in great amounts, seeks a haven in tax-exempt securities, unemployment will become worse than in the darkest days of the depression, and commodity prices will soar. The cost of living will rocket skyward, and any economic gains of recent years will be swept away.

Furthermore, with hundreds of millions of capital forced out of taxable enterprises, the cost of government will fall heavier than ever before upon the wage earner and owners of real estate—the Nation's tangible property. It cannot be hidden from the tax collector, it cannot escape.

The paramount need of the Nation at this moment is encouragement to individual and corporate enterprise—and tax relief.

Congress and the national administration should abandon at once its orgy of spending; discard visionary and impractical plans that are wasting thousands of millions of dollars of the taxpayers' money and mortgaging the earnings of the present and future generations.

It should reduce immediately the staggering overhead cost of government, and eliminate wasteful and extravagant duplications of governmental service. No business enterprise and no government can long endure when it fails to operate within its income. Therefore be it

Resolved, That this meeting urgently and emphatically petition Congress, and particularly the Illinois delegation in the House and Senate, to defeat this hastily drawn and ill-advised measure, and devote the remainder of this session to conscientious and sincere efforts to balance the national budget through substantial economies and retrenchments, and be it further

Resolved, That copies of this resolution be sent to the Chairman of the Senate Finance Committee, the Chairman of the House Ways and Means Committee, and to each member from Illinois in the Senate and the House of Representatives.

THE NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS,
New York, August 8, 1935.

Senator PAT HARRISON,
Senate Office Building, Washington, D. C.

DEAR SENATOR HARRISON: I have attached the original of a report on the proposed Revenue Act of 1935 which report has been prepared by this society's committee on Federal taxation. The report is the result of the studied efforts of a group of leading certified public accountants representing our membership of nearly 2,200.

I recommend this brief report to you. For emphasis, I wish to quote the recommendations with which the committee closes its report:

1. In view of the fact that many corporations are faced with undue hardship because the original declaration of capital is to be perpetuated in principle whereas the rates are to be radically increased, a new declaration of value be permitted in the Revenue Act of 1935.

2. In no case shall the original or adjusted declared value for capital stock tax purposes be reduced below the original declared value, except for capital actually withdrawn. It should be noted that the former excess profits tax laws of 1917 to 1921 contained a similar limitation.

Very truly yours,

JAMES F. HUGHES, *President.*

THE NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS,
New York, August 8, 1935.

Mr. JAMES F. HUGHES,
*President New York State Society of Certified Public Accountants,
New York City.*

DEAR SIR: The committee of the New York State Society of Certified Public Accountants appointed by the President of the society to study present and pending Federal revenue measures has now had an opportunity of reviewing the language of the proposed Revenue Act of 1935 (H. R. 8974) recently passed by the House of Representatives.

The committee has not concerned itself with the political and social aspects of the proposed legislation but has addressed itself to the question of how the law, as passed by the House, should be changed so as to make it an equitable revenue measure.

It is stated in the report made to the House of Representatives by Hon. Robert L. Doughton, Chairman of the Ways and Means Committee of the House, in commenting on the excess-profits tax that:

"Your committee does not provide in this bill for another original declared value, being of the opinion that, since corporations already have had two opportunities to set a proper value on their capital stock, it would be unnecessary from an equitable standpoint to provide another original declaration."

It is apparently the belief of the framers of the bill that, by not allowing a new declaration of value, avoidance of the excess-profits tax or attempt on the part of corporations to limit the tax to the lower excess profits tax rates will be prevented.

The basing of the excess-profits tax on arbitrary valuations of invested capital, self determined by corporations, introduces an element of guess work insofar as the original declared value is concerned. To the extent that taxpayers are held to such a base for calculation of excess-profits tax, when obviously such base can be reduced to zero or even below through application of operating losses, the law has introduced a gambling element comparable with lotteries and other practices now forbidden by other Federal Statutes.

Such a principle forces a corporation's officers to forecast the probable income from operations for the future, and while reasonable estimates can sometimes be made for 1 or 2 years in advance, it is clearly impossible to forecast future earnings per year over an indefinite period, which would be necessary if corporations are

not to be faced with maximum excess-profits tax rates on future earnings which may prove to be only a small annual return on actual invested capital.

Most of the smaller corporations based their original declared value of capital used in their business on reasonable appraisalment of net worth in the belief that earnings would continue to be moderate and that, even if earnings improved, there would be no substantial reduction of the original declared value through application of operating losses but rather an increase due to increase in surplus out of profits accumulated or additional capital paid in. Events since the correlation of capital-stock tax and excess-profits tax was first introduced have demonstrated the unsoundness of applying losses in arriving at the adjusted declared capital value as a base for calculation of the excess-profits tax.

In the case of one corporation that declared what it believed to be a reasonable value for its invested capital in 1934 it has happened that in 1935 a very large bad debt has been incurred with the result that its original declared value under the 1934 law is now reduced to less than nothing.

In another case involving a small private corporation one of the principal stockholders interested therein died in 1934 and it has been necessary for the corporation to itself liquidate the stockholdings of the deceased, with the result that after reducing the original declared value for losses incurred and reduction of capital, as indicated above, this corporation also finds itself with nothing left of its original declared valuation.

How under the 1935 law, as introduced, can such corporations determine their proper excess-profits tax, or is it to be considered the intention of Congress that since, under the law, they have no invested capital, they must pay the maximum rate of excess-profits tax on all future earnings until, through the slow accumulation of years, they have again built up a legal invested capital?

It is the belief of this committee that illustrations such as above demonstrate the impractical, unsound nature of an excess-profits tax based on a certain percentage of return on a valuation which is itself subject to fluctuation through application of results from operations.

The injustice of the present method of determining the adjusted declared value of capital stock as provided for under section 701 of the Revenue Act of 1934 is readily demonstrated.

Assume a corporation fixed its original declared value for its capital stock for the year ended June 30, 1934, at \$900,000 and the adjusted declared value for the year ended June 30, 1936, is \$1,000,000 and that in the calendar year 1936 it earned \$100,000. Its excess-profits tax for that year would amount to \$1,000 as follows:

8 percent of adjusted declared value, not taxed.....	\$80, 000
Balance of income, at 5 percent (\$1,000).....	20, 000
Total.....	100, 000

Suppose for the next 3 years the corporation incurs some extraordinary losses of say \$150,000, \$100,000, and \$75,000 and in the fourth year it again makes a profit of \$100,000.

In this second profitable year it would have an adjusted declared value for its capital stock of only \$675,000 and its excess-profits tax would amount to \$3,250, as follows:

8 percent of adjusted declared value, not taxed.....	\$54, 000
4 percent of adjusted declared value, 5 percent (\$1,350).....	27, 000
Balance of income, 10 percent (\$1,900).....	19, 000
Total (\$3,250).....	100, 000

Thus merely because a corporation was unfortunate enough to have a succession of bad years and incur heavy losses which have to be applied in reduction of its originally declared value of its capital stock its excess-profits tax on exactly the same income earned in a later year rises from \$1,000 to \$3,250 instead of being liable to the minimum rate as before.

Surely this method of taxation is a penalty on the unfortunate corporation that happens to make substantial losses for 2 or 3 successive years. If ability to pay is to be any guide to imposition of taxation then a corporation finding itself in a situation as above outlined, which will not be found unusual in actual experience, should pay less excess-profits tax after 3 years of heavy losses rather than have its excess-profits tax increased threefold.

It would be sounder practice to provide that operating losses or increases in surplus should not affect the original declared value, which should only be adjusted for actual additional capital paid in or withdrawn.

The committee, therefore, is of the opinion that the following recommendations should be made to Congress:

1. In view of the fact that many corporations are faced with undue hardship because the original declaration of capital is to be perpetuated in principle whereas the rates are to be radically increased, a new declaration of value be permitted in the Revenue Act of 1935.

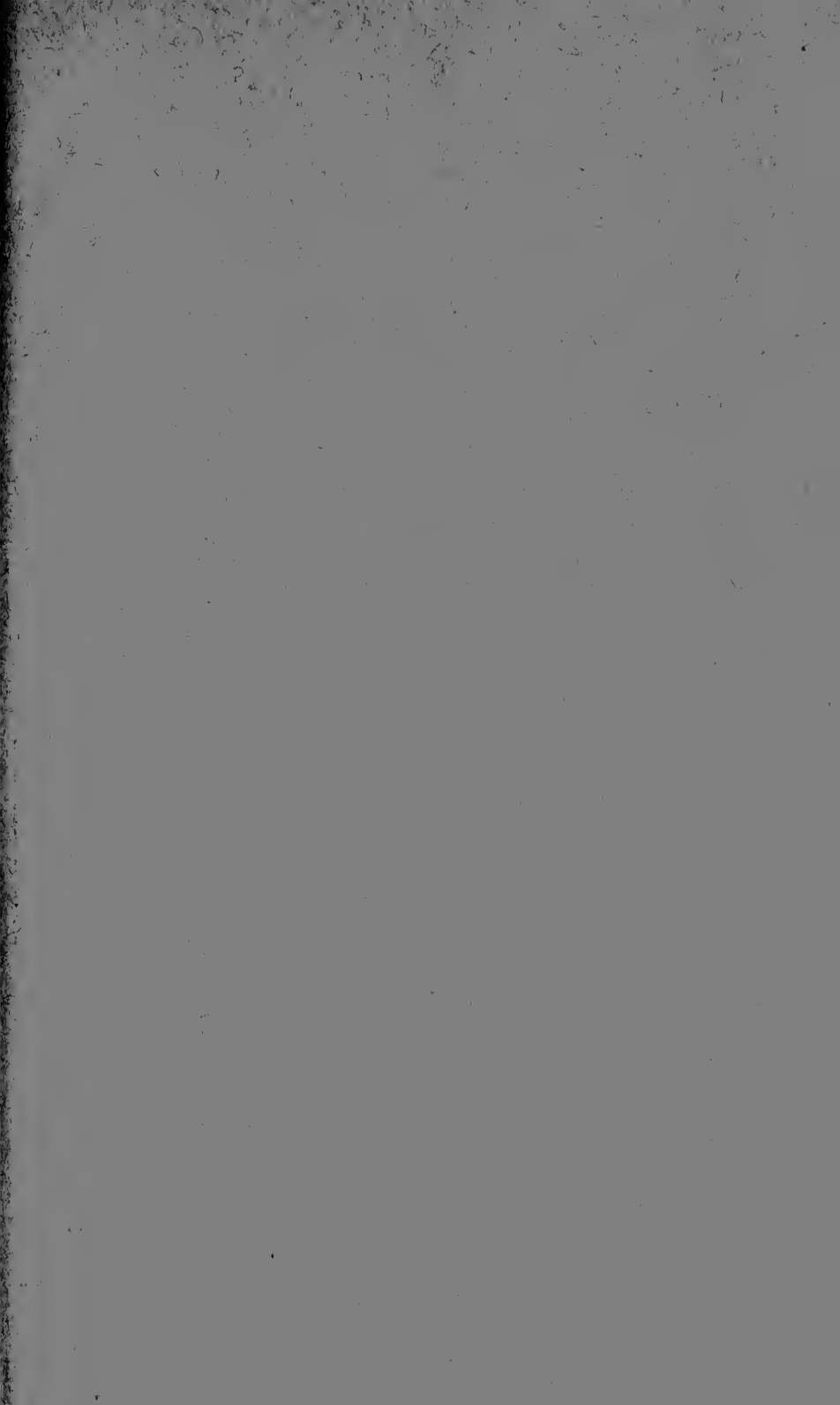
2. In no case shall the original or adjusted declared value for capital stock tax purposes be reduced below the original declared value, except for capital actually withdrawn. It should be noted that the former excess-profits-tax laws of 1917 to 1921 contained a similar limitation.

Yours very truly,

NORMAN G. CHAMBERS,
Chairman Committee on Federal Taxation.

The CHAIRMAN. The committee will recess until 7:30 o'clock tonight, at which time we will take up the alcohol control bill, and in the morning the committee will meet in executive session on this tax bill.

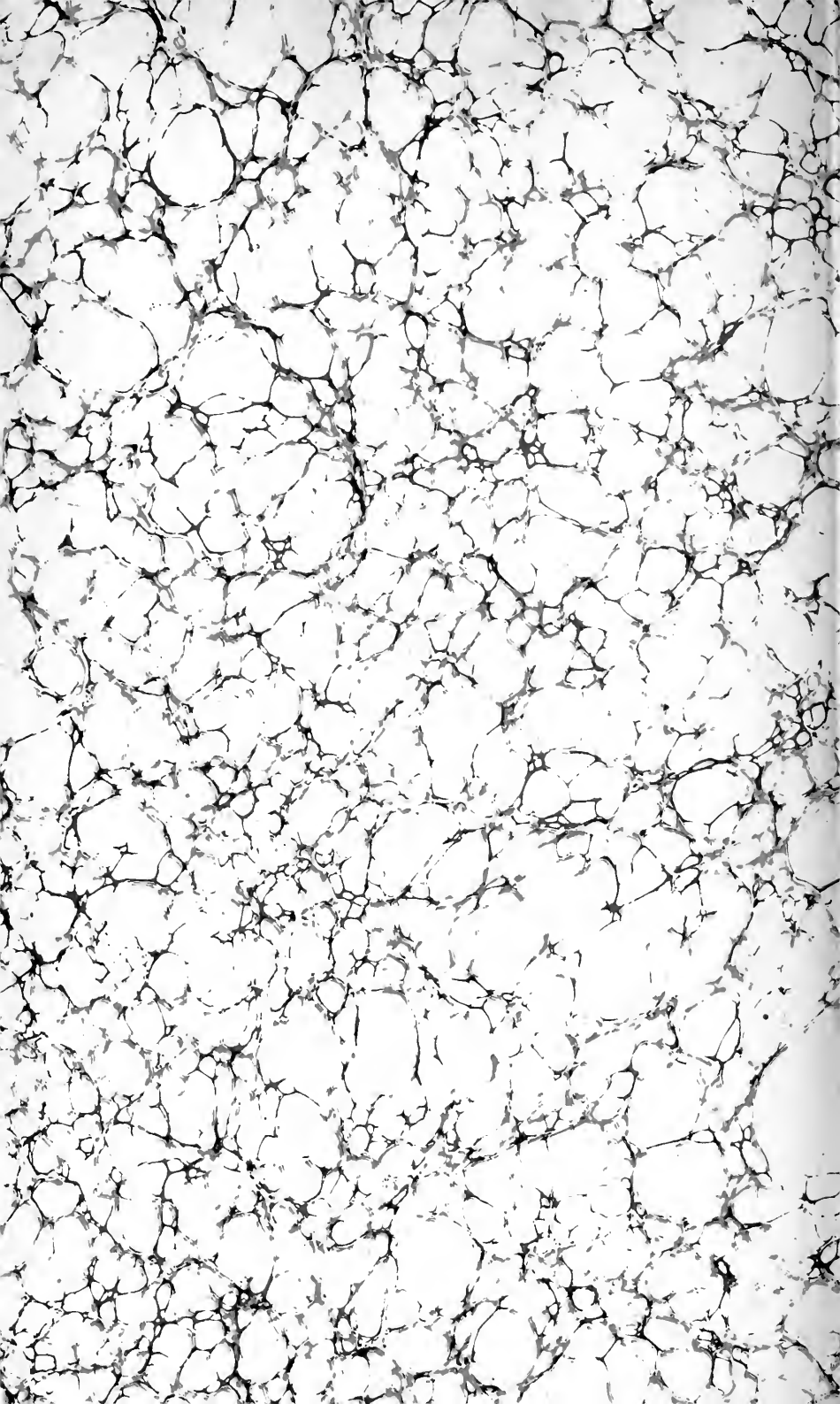
(Whereupon, at 11:55 a. m., the hearings on the Revenue Act of 1935 were concluded.)











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(H.R.8974)

Pt.1

c.1 Revenue Act Of 1935

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AUTHOR

Revenue Act Of 1935

TITLE

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